

What Can an Economic Adviser Do When He Disagrees with the President?

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Assuming he is confirmed by the Senate, Greg Mankiw, a leading Harvard economics professor, will soon be the new Chairman of President Bush's Council of Economic Advisers. The president should be congratulated for such an outstanding choice.

Mankiw may need some advice, however -- a historical perspective, in particular, on what an adviser can do when official White House policy goes contrary to his convictions as a professional economist. Of course, it would be a remarkable coincidence if any president accepted every position that his economic advisers had taken on every issue. But there are likely to be especially large divergences between this president and good economics as represented, for example, by Mankiw's own very popular textbook. This is why I am concerned. I am thinking of such issues as budget deficits, steel tariffs, agricultural subsidies, and conflict with the Fed.

He will be joining an NEC director and Treasury secretary who have already been asked to sell a shift toward budget deficits that appears inconsistent with their past views. But it is possible for a Treasury Secretary or an Assistant to the President to toe the party line while in office, and then confess later that this did not entirely correspond to his true beliefs. (On the subject of budget deficits, see the memoirs of David Stockman and Richard Darman, for example, who were, respectively, Budget Director and Assistant to the President in the first Reagan Administration.¹) A professor of economics like Mankiw, who plans to return to Harvard after his service as a White House advisor, cannot engage in such inconsistencies, without risking losing some of the professional credibility that is so important to an academic career. Indeed, this truth-telling constraint may be the most valuable advantage of having a Council of Economic Advisers, and may explain why Congress legislated the institution in the first place. Encumbered by academic reputations, they are unencumbered by long-term political careers.

It might help to know the variety of strategies tried by past economic advisers, when they have found themselves disagreeing with the president. The history may be

especially instructive in that often the disagreements have been over some of the same issues likely to come up in the current administration.

History

In the late 1960s, President Johnson was advised by his CEA chair Gardner Ackley (and his successor, Arthur Okun) that if he wanted to pursue the increase in defense spending associated with the War in Vietnam, simultaneously with his domestic spending programs, he was going to have to pay for it with a tax increase. The president initially rejected this prescription, on political grounds. He thought that the powerful House Ways and Means Committee would never approve a tax increase, and that to admit the fiscal problem publicly would jeopardize the spending programs. Johnson eventually agreed to an explicitly temporary tax surcharge, enacted in 1968, but it was too late to head off the rise in inflation that Ackley had feared.

In 1971, President Nixon's Council of Economic Advisers argued strenuously against wage-price controls as a response to that same inflation. Paul McCracken, the CEA chair, considered controls "sinful." Herb Stein, the macro member of the Council and ultimately the next Chairman, termed them "wicked." Although George Schultz, then Labor Secretary and also a professional economist, was also opposed, the Treasury Department, other cabinet members, and White House aide Bob Haldeman had come to a view supporting controls.ⁱⁱ Nixon decided to impose a freeze on wages and prices on September 15, 1971. The CEA tried to help make it work the best it could. But, as the advisers had warned, the controls were a bureaucratic nightmare, and the suppression of inflation turned out to be very temporary.

When Ronald Reagan came to the presidency in 1981, he launched a path of tax cuts and increased defense spending, without proposing cuts in domestic spending that would have helped offset the budgetary impact. The resulting budget deficits did not lead to an increase in private saving, as some had hoped, but the reverse. There followed a textbook pattern of capital inflows from abroad, to make up the shortfall in national saving, and corresponding trade deficits. This was the famous "twin deficits" problem, that is now returning in the current decade. In 1983 and 1984, Martin Feldstein, Reagan's CEA chair, did not shrink from speeches and testimony that predicted years of record budget and trade deficits in the future. The implied borrowing from abroad would be sufficient to convert the United States from the world's largest net creditor to the world's largest net debtor. This went over badly among White House aides and in the Treasury Department, where rosier forecasts were preferred. In the February 1984 *Economic Report of the President*, against the wishes of other parts of the government, the CEA forecasted that the merchandise trade deficit would reach \$110 billion that year, almost double the previous record. In Senate testimony, Treasury Secretary Donald Regan was asked to reconcile his own optimistic outlook for the implications of the budget deficit in the *Economic Report of the President*. He pointed out that the latter had been written by the Council of Economic Advisers, not the president. When asked whether he was saying that the congressmen could throw the *Report* in the wastebasket, he agreed that this was the case.ⁱⁱⁱ

The conventional view of this history -- that Feldstein openly or personally defied President Reagan -- is not right. Feldstein had as much claim to be expressing White House policy as did the Treasury Secretary. The president never said a word to his economic adviser indicating displeasure at what he was doing. But then Reagan virtually never confronted subordinates, whether because his easygoing disposition did not abide personal confrontation or because his managerial capacity did not include attention to detail.^{iv} In any case, it is true that Feldstein became less popular in some parts of the administration, even though the twin deficit predictions turned out to be quite accurate -- or perhaps precisely because they turned out to be accurate. When the CEA chair returned to Harvard at the end of his two-year term, the position was left vacant for nine months thereafter, insuring that no more such forecasts were heard in an election year.

For some reason, CEA chairs in the Clinton administration had a slightly easier time of it. Not that their advice was always taken.^v In 1993, Laura Tyson expressed doubts about President Clinton's health care plan in meetings with him. But after the internal policy process reached a decision, she managed to avoid having to sell the ill-fated proposal. In particular, she refused to participate in a White House press briefing in support of the contention that employer mandates would have a positive effect on employment by increasing demand for health care, which she did not believe to be true.^{vi}

In 1997, the Clinton Administration negotiated the Kyoto Protocol on Global Climate Change, even though standard economic models predicted large economic costs if the U.S. had to implement the specified emission cuts domestically. His adviser Janet Yellen *was* expected to sell the policy afterwards -- Congress demanded that she testify regarding the economic rationale for Kyoto. Many in the administration wanted her to testify that technological progress would allow the goals of Kyoto to be met even without politically unpopular incentives in the form of a higher price for carbon-intensive energy, something that she did not believe. But she was able to testify that the economic models did predict only modest costs if the U.S. was allowed to pay for cheap emission reductions in other countries, through a system of international trading of emission permits. Not only was this statement truthful, but it had the substantial advantage of cementing the Administration's position that the treaty would not be submitted to the Senate for ratification unless and until developing countries agreed to meaningful participation and the European countries agreed to a system of international trading of emission permits.^{vii}

Not all advisers have been so fortunate. Mankiw will want to avoid the fate of Michael Boskin, who was CEA chair throughout the four years under his new boss's father. Boskin in 1990 warned George H.W. Bush that recession was coming, and in 1991 objected vehemently to the happy talk that was being written into the president's speeches. At one point he felt it necessary to threaten to resign in order to get a one-on-one meeting with Bush at which he could present his more pessimistic viewpoint unencumbered by aides.^{viii} Later, as employment stagnated, the press widely reported the perception that the White House had neglected the economy, precisely what Boskin had feared, and Bush sank sharply in the polls.^{ix} Three weeks before the 1992 election, as a

desperate campaign move to demonstrate that the president “got it,” the White House in effect tried to blame the economic troubles on Boskin and the other advisers, by announcing that if re-elected he would not reappoint them. That Boskin and OMB Director Darman had already announced that they were not planning on staying on in a second term anyway must have made this ploy particularly frustrating for them.

In December 2002, Bush the Second displayed a similar lack of loyalty to his economic team, in the unceremonious manner in which the White House press secretary announced the departures of Treasury Secretary Paul O’Neill and National Economic Adviser Lawrence Lindsey.^x So watch out, Greg !

Do economic advisers ever “do the honorable thing,” and quit in protest over a policy disagreement? There is less historical precedent for resigning over an issue of policy in the United States than there is in the United Kingdom and some other countries. But two CEA chairmen have done it, in a quiet way. McCracken considered leaving when Nixon rejected his advice on wage-price controls in August 1971, but postponed the resignation four months to minimize negative publicity.^{xi} Ten years later, President Reagan’s first CEA chair, Murray Weidenbaum, did the same thing. The president was forever giving speeches about the need to cut government spending and yet, when faced with actual hard budget decisions, repeatedly declined the aggressive option, even in areas of spending that Weidenbaum considered wasteful. (This included not just domestic spending, but also aspects of the rapidly increasing military spending.) Finally, in late 1982, the CEA chair decided to leave his position early, due to his frustration over this issue and the knowledge that he could not defend the coming budget deficits. But, out of loyalty, he did not publicly resign in protest, nor has he revealed the story since, until now.^{xii}

Lessons

It would be wrong to draw the lesson from this history of disagreements that the economic advisers are always overruled. It would be even more wrong to draw the lesson that the Ph.D. economists as a general rule are smarter or know better than others in the government. There are at least three reasons. In the first place, this article has deliberately singled out a set of relatively rare episodes -- those where “good economics,” as represented by a heavy majority of economists or by leading textbooks, gives some relatively unambiguous answers to major controversial policy questions of the day, and where subsequent history has vindicated these answers fairly clearly (or so it seems to the author). In the second place, in most of these examples, the Council of Economic Advisers was not alone in making its points. Other major players also told Johnson he would have to raise taxes to pay for the war, opposed price controls in the Nixon Administration, worried about rising budget deficits in the Reagan Administration, feared the recession that damaged the first Bush presidency, and had doubts about Clinton’s plans for health care policy and the Kyoto Protocol.

Many top government aides show truly extraordinary levels of intelligence, hard work, and effectiveness. Sometimes this characterization even describes the president himself. I know from firsthand experience that it described Bill Clinton, and I have no

grounds for doubting those who say that it also described Lyndon Johnson and Richard Nixon, whatever their other faults. In any case, the third point is the most important: any president has to weigh in many factors besides what economic theory says, including many political factors. That is their job, in a democracy. In my view, a system in which the CEA gives advice that is a few steps farther removed from political reality than the rest of the White House, and in which the president then does something different from that advice because he sees a larger picture, is a system in which everybody is doing his or her job properly.^{xiii}

But the public, Congress, and the media should “do their jobs properly” as well. This includes putting members of the Council of Economic Advisers on the spot, when White House policy appears to deviate from good economics.

Mankiw has one major factor working in his favor: in these situations, the press and Congress seldom ask persistent or sophisticated questions. Or, if they do ask these questions, the answers don’t get reported to the public. So one can usually come up with a careful sentence that appears to be consistent with the White House line and yet is not literally false, and get away with it. His immediate predecessor, Glenn Hubbard, did well with this strategy, which helped him win a powerful role as an administration insider.^{xiv} He formulated language that “long-term interest rates do not move in lockstep with actual or expected federal budget deficits.”^{xv} He, like Mankiw, has a textbook with the standard model linking interest rates to budget deficit. But because the sentence is true as written, under this strategy Hubbard has little to fear from his colleagues when he returns to university life. The press did not ask the obvious follow-up questions. (“OK, we understand that budget deficits are not the only factor that determine interest rates. But, in your view, doesn’t a budget deficit cause real interest rates to be higher than they otherwise would be? And regardless whether that increase is small, isn’t it still true that the deficit crowds out investment?”) Perhaps the press is giving this Bush an easier ride than his predecessors due to the post-September-11 national mood. Perhaps the press perceives correctly that its readership lacks the attention span or interest in policy details necessary to read complicated stories. In any case, the hard questions have not yet been asked, or at least not reported. So Mankiw’s best bet is probably this same strategy. If he can get away with it.

What is Wrong with Current Fiscal Policy

To be fair, some press reports have sought to point out contradictions between Bush economic policy and the previous writings of Mankiw and Hubbard. It has been claimed that Hubbard in office contradicted his textbook on the relationship between deficits and interest rates. Unfortunately, if one consults the written record, these reports appear to be not entirely accurate. As so often, the truth is more complicated. But not too complicated for a freshman economics student to follow.

Consider two precise claims regarding fiscal policy.

- (1) [Laffer proposition] Tax cuts improve economic incentives and increase economic activity so much that tax revenue and the budget surplus actually increase.
- (2) [Ricardian neutrality proposition] Even if the budget balance worsens, there is no upward effect on real interest rates and no crowding out of investment (including both domestic investment and the current account).

The first Reagan Administration and the current Bush Administration both give the impression of having based their fiscal policies on these two beliefs. Some individuals associated with these administrations indeed held these views – guiding intellectuals who may never have held office as well as high-ranking policy-makers who did.^{xvi} But not all. In particular, so far as I know, Glenn Hubbard did not utter either of these claims, and thus did not contradict his textbook in the way that has often been alleged. To the contrary, the 2003 *Economic Report of the President* says, “The modest effect of government debt on interest rates does not mean that tax cuts pay for themselves with higher output. Although the economy grows in response to tax reductions...it is unlikely to grow so much that lost tax revenue is completely recovered by the higher level of economic activity” (p.57-58).

The calculation in which the CEA concluded that the budget deficit would have only modest upward effects on interest rates -- “the \$1.3 trillion in tax relief included in EGTRRA [the Economic Growth and Tax Relief and Reconciliation Act of 2001] would raise interest rates by only about 19 basis points” – was based on the marginal product of capital. Many econometric estimates of the interest rate effect, which are based on actual behavior rather than a theory that equates financial interest rates with the marginal product of capital, are higher.^{xvii} But it hardly matters. The CEA calculation in effect concedes what many in the Bush Administration would like to deny: that the long run impact would be to reduce cumulative national saving and national investment by a corresponding magnitude (with an estimated 60% of the crowding out showing up in regular national investment and 40% showing up in investment abroad, i.e., in the current account balance). There is little disagreement that lower investment in the long run means lower growth in productivity and income. Does it really matter if the mechanism that achieves this crowding out is a large increase in interest rates or a small one? In other words, it is not Hubbard’s precise statements that need to be refuted, so much as the support they imply for a policy of fiscal indiscipline.

Hubbard has also been attacked for deriding “Rubinomics.” Here again, his attempt to defend budget deficits does merit rebuttal, and it indeed seems tactically foolish for him to have made his attempted defense by means of an attack on one of the most popular and successful Treasury Secretaries in US history. But Hubbard’s precise claims are not what is widely assumed. Consider two more propositions:

- (3) A fiscal expansion today, in a context of long-term fiscal responsibility, increases short-term growth, particularly if the economy was already in recession.

- (4) A shift toward a path of long-term fiscal indiscipline is bad for growth in the long term and -- if properly perceived today -- raises long-term interest rates and exerts a negative effect on growth even today.

Both of these statements are standard textbook economics. Robert Rubin's claim is that the shift in fiscal path undertaken by the Clinton Administration, starting with the 1993 Omnibus Budget Reconciliation Act, helped make possible the long strong expansion of the Clinton years. Hubbard is seeking to attribute to Rubin the general claim that a fiscal contraction today necessarily increases growth (the opposite of proposition 3). Pundits are in turn attributing to Hubbard the claim that a shift toward a path of long-term fiscal profligacy exerts a positive effect on growth (the opposite of proposition 4). Both claims would be bad economics, if they had been made, but neither attribution is in fact entirely correct. What complicates matters is that in practice most changes in fiscal policy carry implications for both the short term and the long term. Budget deficits that are observed in the present undercut the credibility of proclamations by the government that it will get religion in the future. (Think 1981, or 2001.) A reduction in short-run deficits is usually a necessary part of credible plan for long run fiscal balance. (1993.) Rubin's true position is that the short run reduction in deficits following the 1993 budget plan (OBRA) helped make credible the simultaneous announcement of a long run path for restoring fiscal balance, that the combination of the two kept interest rates lower and investment higher than they otherwise would have been, and that the overall economic effect was positive. In light of the good performance of the economy during the Clinton Administration, Rubin's belief that this characterization is the relevant way of combining propositions (3) and (4) seems right. Hubbard's true position, I surmise, is that the short-run increase in fiscal deficits following the 2001 budget plan did not undermine the credibility of the announced long run Bush fiscal path, and that the net economic effect was positive. The claim that this is the relevant way to combine propositions (3) and (4) seems to me highly dubious. To the contrary, the current administration has radically shifted the outlook in an undesirable direction.

Hubbard and the White House are right that the deficits incurred in 2001 and 2002 served in the short run to dampen the recession, that as a share of GDP they are not unprecedented, and that they do not in themselves necessarily imply an explosive path of national debt. The problem, however, is that the changes in tax policy that they have legislated have placed the economy on a fiscally unsustainable path for the longer term.

Let's recap the recent history, since memories are short. In the election campaign of 2000, candidate Bush denied that his proposed tax cuts would wipe out the budget surplus that had been painstakingly achieved in the course of the 1990s; indeed he promised to leave untouched the part of the surplus arising from social security revenues. When the Bush team took office, and got their tax cuts passed, they repeated the promise, though now they snuck into some speeches the proviso of an escape clause in the event of recession, war, or national emergency. In January 2001 they projected a \$5.6 trillion surplus over ten years. Immediately after the cuts had been passed (EGTRRA) – and before September 11 – revised projections showed that the situation was far worse than that. The tax cuts had killed the surplus. But the devastating attack on the World Trade Center came soon enough to confuse many Americans as to the true culprit.

As recently as mid-2002, the Congressional Budget Office was still projecting a ten-year surplus of \$1.0 trillion and the Office of Management and Budget a cumulated surplus of \$1.7 trillion. It has taken two years of steady downward revisions by OMB and CBO before they confessed what had been evident to many, that the surplus was gone. The January 2003 figures released by CBO show that the ten-year budget surplus has fallen from \$5.6 trillion to \$0.02 trillion. The current deficits are now seen as lasting for years to come. So now, following the same sequence as the Reaganites before them, the Bush Administration has stopped arguing that there won't be deficits or that they will soon go away, and has instead started arguing that deficits of this size don't matter.

Even now, however, the official forecasts continue to understate the magnitude of the fiscal disaster. It is inevitable that such long-term projections will be subject to large measurement errors in one direction or the other. But the OMB and CBO forecasts have been corrupted by ten sources of bias in the optimistic direction.^{xviii}

1. The predictions of economic activity and tax receipts have been systematically overly optimistic. The 2001 forecasts did not factor in the likelihood that a recession would probably occur sooner or later, that the productivity boom of the late 1990s would prove partially unsustainable, or that the boost to tax revenues from a bubble stock market might not continue. Official forecasts have continued to call for an average growth rate around 3.3 per cent over six years, which relies on most of the productivity acceleration that took place during the Clinton years turning out to have been permanent, notwithstanding the damage done in the meantime to the more extreme versions of the IT/New Economy view. (Admittedly, many private forecasters are close to that.) More worrisome is the increasing political pressure on professional forecasters in the White House and Congress to err in the optimistic direction. So far the Congressional Budget Office has held out against efforts from the Republican right to politicize it and to get more optimistic revenue forecasts out of the slogan "dynamic scoring." But CBO may not hold out forever.
2. The forecasts do not include the cost of the war in Iraq, or efforts to rebuild the country. Whereas the first George Bush in 1990 paid enough attention to other countries' views to be able to put together a coalition in support of the war to liberate Kuwait, and to convince the allies subsequently to reimburse the United States for the cost of the war, this George Bush has not followed this approach. Recent White House estimates reportedly put the cost at \$60 billion for the war and \$30 billion for reconstruction. Estimates from Bill Nordhaus range far higher.^{xix}
3. Official forecasts assume that domestic discretionary spending will increase only at the rate of inflation. In fact, spending has been increasing far faster than that (8 percent over the preceding four years, rather than 3 percent.) This will also be the pattern in the foreseeable future.^{xx} One reason to believe that the spending discipline of the 1990s is gone for good is that the caps on discretionary spending that were originally agreed in the Budget Enforcement Act of 1990 have recently expired, and there is no discussion of restoring them. Assuming, more realistically, that spending will increase in step with the size of the

economy adds more than \$1 trillion to the 10-year budget deficit, according to the Concord Coalition.

4. Another reason to be skeptical of plans that rely on fiscal rectitude returning anytime soon reason is the end of two-party gridlock. Divided government in the 1990s meant that the Republicans in Congress were blocked from cutting taxes, while the Democrats were blocked from increasing spending. Now that all branches of government are in the hands of the Republicans, there are no checks.
5. Another reason that the fiscal discipline of the 1990s has vanished is that the principle “Save Social Security first,” which both parties had supported, and which in effect dictated a bright-line constraint on how much of the budget surplus could be spent, has vanished. The nation blew right through that roadblock in 2001 without even noticing.
6. Next comes Social Security itself. The politicians have not just spent the non-Social Security surplus, but they have also spent the Social Security surplus. If the accountant is not going to look far enough into the future to worry about the large outlays that have been promised to the next generation of retirees on the debit side of the balance sheet, then he should at least not count the revenues currently coming in from payroll taxes on the credit side. Taking the net Social Security revenues out of the official budget numbers costs another \$2 ½ trillion on a ten-year basis.
7. The next four on the list of ten reasons for fiscal pessimism, are further changes in the tax system that will lose revenue, if they are passed.^{xxi} In his February 2003 State of the Union address, President Bush proposed abolishing the tax on dividends, at a ten-year cost of \$0.4 trillion.
8. In addition, he proposed making permanent the upcoming reductions in individual income tax rates, the 2010 abolition of the estate tax, and other tax cuts that are disingenuously on the books treated as expiring over the next ten years. The proposal to make tax cuts permanent loses \$1.2 trillion dollars over ten years.^{xxii} These proposed changes are reflected in the current official budget estimates, as are the costs of the dividend tax elimination, and other newly proposed fiscal stimulus. But most of the money that these proposals would lose is in the more distant future and thereby not counted. In the meantime, the Administration has switched from emphasizing a ten-year budget window to a five-year budget window in reporting its projections.
9. The same is true of the proposal to expand and consolidate the system of tax-preferred saving accounts -- IRAs and 401(k) plans. Since the new saving vehicles would tax the income when it is saved, but make the accumulation and withdrawals tax free, it is designed to lose money outside the 5-year budget window. (Looking ahead 75 years, all the Bush tax cuts combined lose \$12 to \$14 trillion dollars, more than the projected shortfall in Social Security and Medicare.^{xxiii})
10. Finally, we will eventually have to fix the Alternative Minimum Tax. Current official projections make the unrealistic assumption that this unpleasant tax will be allowed to hit a fraction of households that is vastly enlarged due to inflation – 36 million in 2010, as compared to 2 million this year and far fewer in the original intention.^{xxiv} It is estimated that it will cost \$0.6 to \$0.7 trillion dollars

over the next ten years to fix this, in the sense of returning the fraction of the population that is unintentionally hit by this tax to the same proportion as today. The Bush Administration supports such an adjustment, but hasn't included the cost in its figures.

These ten reasons to believe that the long-run fiscal outlook is worse than what the official projections say, on top of the steady downward revisions that have already taken place over the last two years in the official projections, add up to a truly massive shift in the direction of fiscal irresponsibility.

It is common for a president to campaign on a low-tax platform, and then later have to adjust to budgetary realities. Reagan had to raise taxes in his first administration, after the initial fiscal changes produced a rapid run-up in debt and interest bills. Bush in 1990 reversed the "no new tax" pledge. Clinton essentially abandoned his proposed middle class tax cut even before he took office. The question is how long it will take before the fiscal realities become so overwhelming that even the occupants of the White House cannot ignore them.

Of President Bush's economic policies, bridging the gulf between his fiscal policy and economic reality is likely to pose the greatest challenge for his new economic adviser. Like the CEAs that served under Johnson and Reagan, Mankiw's biggest task should be to point out that the paths of spending and taxation that have been plotted by the administration are not consistent with budgetary responsibility. If he is skillful, he will be able to formulate sentences for public use that appear superficially to support the White House's line and yet are consistent with his own textbook. He may even choose a strategy, like his predecessor's, of maximizing support for administration policy, subject to a minimum constraint of academic respectability, and thereby gain a major insider role. But he might eventually find it more difficult to agree with claims by the Administration that the long run fiscal path on which it has embarked is a responsible one.

APPENDICES : FOR THE RECORD

Appendix 1: Response of Laura Tyson, CEA Chair under President Bill Clinton (1993-1995), to author's question about her differences with Clinton's health care plan. (March 2, 2003)

It is certainly true that my greatest area of disagreement with the President was over health care policy. In 1993, I raised questions about the President's plan in a number of meetings with him. The most reported of these meetings was a cabinet meeting in the summer of 1993 when in front of the whole cabinet, I raised questions about his argument that health care was becoming too large a fraction of GDP and about Hillary's argument (she was in the room, my question was directed to her) about whether the savings from greater efficiency in the health care system from their health care proposal would be adequate to cover all of the uninsured without a deterioration in quality or the possible rationing of health care over time. Both the President and the first lady disagreed with me. I also raised serious objections to the [Ira] Magaziner taskforce contention that employer mandates would not only not result in a reduction in employment but would actually increase employment overall by increasing demand for health care. This is the particular point I refused to defend publicly by refusing to do a press conference or press briefing that Ira wanted to arrange to deflect criticism of the employer mandate proposal. I did agree to do some "selling" of the Administration's health care proposal but I was careful about the terms. For example the 1994 ERP contained a chapter on the plan--it made the economic case for why health care reform was needed; and it described the President's plan--but it carefully and intentionally did not endorse the plan's particulars. I also argued for the Administration's position that private insurance markets were riddled with imperfections which was why a national health care plan was necessary in the first place.

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Appendix 2: Response of Michael Boskin, CEA Chairman under President George H.W. Bush (1989-1993), to author's questions regarding his differences with some in the White House over expressions of optimistic economic outlook. (March 14, 2003.)

In brief summary,

I told the President at Camp David in the summer of 1990 that a recession was virtually certain (the dating to July 1990 occurred much later when data for that period were revised down sharply -- at the time, the data suggested growth in Q3 1990).

2) There was a big battle in the Oval Office in early 1991 with [Chief of Staff John] Sununu and [Budget Director Richard] Darman arguing for the "talk up the economy" approach, [Treasury Secretary Nicholas] Brady neutral and me vehemently opposed. I argued (and similarly to the current President in 2001 and 2002, who took the advice) that it was substantively and politically much better to be accurate in describing the current state of the economy, reserving optimism for our economic future and our economic system.

3) I was never denied access to the Oval Office. I was denied, as was almost everybody else, a one-on-one with the President to make my case. I did -- after some delay and my threat of

resignation -- have a one-on-one with the President, which was very rare for anyone to get. I made my case and suggested not only that the tone was way off and that my attempts to edit his speeches had been thwarted -- but that he needed a program to stimulate the economy. I developed a set of tax measures -- investment credits and incremental employment tax credits, but the President decided, on other advice, to ride it out. We did, however, as a result of my insistence on doing something on the fiscal side to help the economy in the short run, enact an adjustment in withholding schedules, which partially offset the over-withholding that had been progressively building for many years. It amounted to a "tax cut" of a little less than 1/2 % of GDP.

4) In the interim, I (and two or three others) developed the regulatory relief moratorium, which was widely viewed internally as a great success.

5) Nobody ever tried to blame me for the economy. There were attempts to blame me for the perception the President was not in touch with the economy (by the political and communications people who were themselves out of touch with reality). The initial attempt to shift blame to the CEA or me personally was a clumsy attempt by desperate White House political advisors in late 1991/early 1992, which crashed when I publicly pointed out the economy was exactly on the course (with the data then available) that had been projected in the ERP, i.e., an anemic recovery, which the President had signed. This stopped that talk cold.

6) Next -- there were leaks and rumors at the August 1992 Convention. In any event, I had already announced I had no intention to stay. In fact, the President had talked me into staying an additional two years when I'd told him I was planning leaving after two years in 1991.

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Appendix 3: Circumstances of resignation of Paul McCracken, CEA Chairman under President Richard Nixon (1969-1971), as reported by his Chief of Staff, in Jones (2000. p.63).

In a retrospective interview many years later, McCracken explained the reason for his resignation on December 31, 1971, after staying on for several months to try to help the new economic program get off to a positive start in restoring stronger growth. The timing and dignified nature of his resignation once again demonstrated his personal character in forgoing an earlier opportunity to play the role of a martyr by dramatically resigning in August to publicly protest the use of mandatory controls which, he had correctly predicted during the internal debates, would be counterproductive. He made the careful calculation that he should resign and then adjusted the timing to minimize the negative publicity that would have resulted if he had quit at the sensitive beginning point of the new program (which he strongly supported other than the ill-fated wage and price controls component):

In my own case, the point at which, in retrospect, perhaps I should have resigned was in the latter part of 1971 when the President went to wage and price controls. I had opposed that sort of thing, not only within the administration, but for a long period of time. I have no reason even yet to change my mind that these controls don't work, and I would have to say in all candor that perhaps the game plan had changed enough at that point that I should have said, "I've got to step off the team."*

* p. 326 in Erwin Hargrove and Samuel Morley, eds., *The President and the Council of Economic Advisers: Interviews with CEA Chairmen*. Westview Press: Boulder CO, 1984.

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Appendix 4: Circumstances of resignation of Murray Weidenbaum, CEA Chairman under President Ronald Reagan (1981-1982), as reported in personal correspondence with the author:

(Feb. 21, 2003)

Following many meetings at which I argued unsuccessfully with President Reagan about the need to make substantial spending cuts especially in the military budget, one day in the latter part of 1982, after a quiet Cabinet meeting, I just told him that the time had come for me to return to Washington University. Because I had so many prior opportunities to present my views on that subject and many others, I did not elaborate on my firm desire to return to St. Louis.

My basic attitude was that I was there to serve the President, which included publicly defending his budget. When I felt that I could no longer do that, it was up to me to quietly fold my tent and go home....

(Feb. 25, 2003)

As for my leaving early, I had to break the two-year lease for the apartment I rented in DC -- by citing the provision that allowed me to do so if my presidential appointment were terminated (I wrote that circumspect language, too).

Yes, my motive for leaving was my concern over the large impending budget deficits -- and the lack of restraint on spending, especially what I considered wasteful or uneconomical outlays....

ⁱ They appear to have understood the budgetary arithmetic that Reagan did not understand: that the tax cuts and defense spending increases that were launched in 1981 would result directly in larger budget deficits, in the absence of drastic cuts in domestic spending that the president was not prepared to propose. Stockman, *The Triumph of Politics* (Harper and Row, New York), 1986. Darman, *Who's in Control?* (Simon and Schuster, New York) 1996. For example, Darman essentially confirms Stockman's story of a conversation in the West Executive parking area in early 1981, when both had become concerned that the tax cut proposals had gotten out of control, and Darman said "I don't know which is worse, winning now and fixing up the budget mess later, or losing now and facing a political mess immediately" (p. 89-90). Stockman relates that Reagan was never prepared to make the drastic budget cuts that would have made the tax cuts consistent with fiscal responsibility (Chapter 12), and concludes, "What do you do when your President ignores all the palpable, relevant facts and wanders in circles?" (p. 375).

ⁱⁱ Sidney Jones, *Paul McCracken: Public and Private Economic Adviser* (University Press of America: Lanham, MD.), 2000, pp. 237-262, 282. Herbert Stein, *Presidential Economics* (American Enterprise Institute, Washington DC), 1988, p. 143.

ⁱⁱⁱ Senate Budget Committee, February 3. For Feldstein's retrospective view on his disagreements with the supply siders in the Reagan administration, see his chapter in Feldstein, ed., *American Economic Policy in the 1980s* (University of Chicago Press: Chicago), 1994, p. 24-30.

^{iv} For example, the famous story that President Reagan "took David Stockman to the woodshed" when the Budget Director's indiscretions over fiscal policy appeared in the *Atlantic*, never in fact happened, but was invented for the press, according to the memoirs of Stockman (*op. cit.*, p.4) and Darman (*op.cit.*, p. 109) .

^v See Jeffrey Frankel and Peter Orszag, eds., *American Economic Policy in the 1990s* (MIT Press: Cambridge), 2002; particularly the chapters "The Process of Economic Policy-Making During the Clinton Administration," by Jonathan Orszag, Peter Orszag and Laura Tyson; "Health Policy in the Clinton Era: Once Bitten, Twice Shy," by David Cutler and Jonathan Gruber; and "Introduction," by Frankel and Orszag,

^{vi} Personal correspondence, Appendix 1.

^{vii} Frankel, "You're Getting Warmer: The Most Feasible Path for Addressing Global Climate Change Does Run Through Kyoto," forthcoming in *Trade and the Environment in the Perspective of the EU Enlargement* (Edward Elgar Publishers, UK), edited by Marialuisa Tamborra and John Maxwell, 2003.

^{viii} Personal correspondence, Appendix 2.

^{ix} Incidentally, this perception was not completely fair. The public and press at the time thought that the 1990-91 recession was an unusually severe one, when in fact it was an unusually mild one. They thought it was still underway in 1992, when in fact it was over. And they thought President Bush was pre-occupied entirely with foreign policy, when in fact he spent much time on the economy. (Most presidents, if they are competent, spend their time on a huge array of issues. It is a failure of imagination on the part of the press and public, who usually can't focus on more than one big issue at time, to assume the same about the White House.)

^x The two episodes differed in that the NEC director and Treasury Secretary in December 2002 had not previously planned on leaving. But the two episodes do have in common that the president and his chief of staff made a deliberate decision, for political reasons, to gratuitously impose a personal cost on individual members of the economic team. To make this analogy is not to say that the two Bushes were the only presidents liable to charges of imperfect loyalty to the people who work for them. Furthermore, if one had the responsibility of weighing in the balance some small ego bruises to two or three individuals, on the one

hand, against what one believed was the overall welfare of the country, on the other hand, sacrificing the egos might even be the right decision.

^{xi} Jones, *op cit.*, quoted in Appendix 3.

^{xii} Personal correspondence. excerpted in Appendix 4.

^{xiii} On the role of the CEA in the White House, see Roger Porter, "The Council of Economic Advisers," in Colin Campbell and Margaret Wyszomirski, *Executive Leadership in Anglo-American Systems*, University of Pittsburgh Press, 1991; and "Presidents and Economists: The Council of Economic Advisers," *American Economic Review*, May 1997, 87, no. 2, 103- 106.

^{xiv} "the most influential chairman of the Council of Economic Advisers in two decades," according to Fred Barnes, "The Four Horseman of Bush Economic Policy," *The International Economy*, Winter 2003; reprinted in *Weekly Standard*, Jan. 20, 2003.

^{xv} Hubbard, "Remarks," AEI, December 10, 2002; *Tax Notes* 30th Anniversary (p.8).

^{xvi} Some Reagan supporters claimed after the fact that nobody who held an important office in that administration ever asserted the Laffer hypothesis (proposition 1). Among many counterexamples to this claim is the Secretary of the Treasury, who, even after events had falsified the proposition, wrote of his "very strong opinion that a tax cut would produce more revenue than a tax increase" -- Don Regan, *For the Record* (St. Martin's Press: New York) 1988, (p.214). And: "The increase in revenues should be financed not by new and higher taxes, but by *lower* tax rates that would produce more money for the government by stimulating higher earnings by corporations and workers..." (p.173).

^{xvii} A comprehensive and up-to-date review is William Gale and Peter Orszag, "The Economic Effects of Long-Term Fiscal Discipline," Urban-Brookings Tax Policy Center Discussion Paper, Dec. 17, 2002.

^{xviii} The list is similar to, and in part draws on, estimates from the Concord Coalition, Brookings Institution (Alan Auerbach, William Gale, and Peter Orszag, "The Budget Outlook and Options for Fiscal Policy," Brookings Institution, April 2002), and Committee for Economic Development ("Exploding Deficits, Declining Growth: The Federal Budget and the Aging of America," A policy statement by the Research and Policy Committee of the CED, Washington, DC, March, 2003). Most of the bias occurs because CBO must base its projections on current legislation, and is thus not the fault of the staff.

^{xix} "The Economic Consequences of a War with Iraq," in Carl Kaysen, et al, *War with Iraq: Costs, Consequences, and Alternatives*, American Academy of Arts and Sciences, Cambridge MA, 2002, p. 51-86.

^{xx} There are many examples of spending programs that we do not appear able to afford. Members of both parties support prescription drug benefits, agricultural subsidies, and the manned space program. The Bush people are particularly fond of allowing the exploitation of forests, oil, and other natural resources on federal lands at prices that are below market cost, just the opposite of the penalty rates that good economics specifies for such cases of environmental externalities.

^{xxi} The pay-as-you-go rule, which was passed in the 1990 Budget Enforcement Act and prevented tax-cutting policy changes unless they could be paid for elsewhere by increases in other taxes or reductions in entitlement spending, has like the spending caps recently expired.

^{xxii} The figure includes the routine extension of other tax cuts due to expire, and is from the CED, *op cit.*, p. 14. The number is \$1.4 trillion if interest costs are included, as they should be. The Concord Coalition had similar estimates last year.

^{xxiii} Peter Orszag, Richard Kogan, and Robert Greenstein, "The Administration's Tax Cuts and the Long-Term Budget Outlook," Center on Budget and Policy Priorities, Washington, DC, March 19, 2003.

^{xxiv} “Fixing the AMT” here does not mean abolishing it, but adjusting it so that it affects the same proportion of the population in 2010 as it does today. Auerbach, Gale, and Orszag, *op cit*.