Transcript
U.S. Senate Democratic Policy Committee Hearing
"Will the Bush Economic Plan Create Jobs?"
June 9, 2003
Washington, D.C.

U.S. Senator Byron L. Dorgan, Chairman

We're going to call the hearing to order this morning. This is a hearing of the Democratic Policy Committee. The subject today is "Will the Bush Economic Plan Create New Jobs?" I'm joined by several of my colleagues; others will be arriving soon. Senator Feinstein, Congressman Scott, Congressman Levin, who's going to be leaving briefly and then returning to the hearing at some point. Let me just begin with a brief opening statement and then call on any of my colleagues for any statement they wish to make.

The question is, what kind of plan, what kind of economic plan, leads to the creation of new jobs? In the last couple of years we've seen the loss of 3.1 million jobs in this country. There are a lot of reasons that people give for that: 9/11, war on terrorism, corporate scandals, the bursting of the technology bubble, a recession, but more basic, we have a monetary policy that is providing interest rates now at their lowest levels in many, many decades. With one and a quarter percent interest rate at the fed it's pretty hard to see there's much more juice in monetary policy. We have a fiscal policy that we put in place two years ago. The "President Bush Plan" in 2001 was enacted by Congress two years ago. We have just in recent weeks here in Congress approved the second installment of President Bush's fiscal policy. Despite all of this we have fewer jobs and we have more unemployed. Some would blame it on Bill Clinton, some Jimmy Carter, some perhaps Millard Fillmore; at this point, we have a fiscal policy, however, that this administration has proposed, a policy that they say will create jobs or at least create the climate in which jobs will be created. The question is, why hasn't it worked, and will it work.

Now, the field of economics is really, in my judgment, mostly psychology pumped up by a little helium. There are those who think they have precise answers using tools given them in the field of economics, but in my judgment the engine room of this ship of state is really not about levers and gauges and dials and knobs, getting them all just right so that the ship of state moves forward unimpeded. It's all about confidence. This economy in my judgment rests on a mattress of confidence; if people are confident about the future, they do things that manifest that confidence. They buy a car, buy a home, take a trip, make a purchase, and that is the expansionary side of the economy: confidence. Confidence in the future. If they are not confident in the future, they do exactly the opposite. They defer the trip, defer the purchase, don't buy the car, don't buy the house. That's the contraction side of the economy: lack of confidence in the future.

In at least my view, and I hope to be able to explore this at this hearing, here is a report that has been much noted in the last two weeks that suggests that in the long term we have a fiscal policy that is so seriously out of balance it's almost breathtaking. This report was prepared by the Deputy Assistant Secretary for Economic Policy at the Department of Treasury, Mr. **Golchael** and Mr. Kent Smetters. Mr. Smetters was a former Deputy Assistant Secretary for Economic Policy. This report, which apparently was supposed to have been part of this year's budget document sent to Congress but was not, says that our total fiscal imbalance is equal to 44.2 trillion dollars. Now that's a number that's hard for anyone to comprehend, but it's quite clear to me that the numbers don't add up.

Comment: Check spelling.

We face in the next five, ten and fifteen years the retirement of the largest group of babies ever born in America. The largest outpouring of affection in the history of our country occurred at the end of the Second World War and more babies were born than have ever been born before. When they begin to retire we have this demographic explosion here in fiscal policy and there is no way to meet it with more and more and more tax cuts. I think most people who look at all of these numbers say that these numbers don't add up. They create a lack of confidence in the future and the result of that lack of confidence is that the economy does not progress. The climate for the creation of jobs does not exist. And so we're going to talk about that today. We have some fascinating witnesses and with that let me call briefly on my colleagues, beginning with Senator Feinstein.

Senator Diane Feinstein

Thank you very much Mr. Chairman and thank you very much for organizing this hearing. I'm delighted to see Mr. Reich and Mr. Kemp who are going to begin. They're certainly most welcome. I wanted to start off by saying a few words about the California economy, and the reason I do so is because the California economy is such a large engine that it drives much of the nation's growth, really whether people like it or not.

During the late 1990's, California was the engine of much of the nation's growth. The annual GDP growth in the San Francisco Bay Area alone was well over ten percent. The state unemployment rate fell to a thirty-one year low of four and a half percent in February of 2001. Now California's unemployment rate is a half point higher than the national average, at 6.6 percent, and parts of the state's economy are still shedding jobs. Venture capital funding, once the primary economic fuel of Silicon Valley, remains well below its 2000 high and billions of dollars in funds remain un-invested due to economic uncertainty. Nationwide, venture funding in '02 totaled less than a fifth of the amount invested in 2000. I was amazed when the Governor and members of the Legislature told me that in 2000 the options from seven Silicon Valley companies represented thirteen percent of the state's budget, if you can imagine that. Now California has a highly educated, service-oriented workforce that's a model for the country, and economic weakness in the state is a bad sign for the future of our economy. Nationwide, I believe, and this is one of the reasons I believe the tax cut isn't going to have an impact, the geopolitical uncertainty and the lack of investor confidence must really be addressed before we can see the return of healthy economic growth.

Alan Greenspan made clear during his recent testimony before the Joint Economic Committee the same thing that he told the Centrist Coalition of this body privately, and that is the continued fears about our security at home and abroad have dampened new investment and fostered a wait-and-see mentality. Investors remain wary of putting their money into the stock-and-bond market due to fresh corporate scandals, a lack of transparency in corporate financial statements, and inadequate enforcement by independent regulatory agencies.

In the face of this continued uncertainty, and what remains a true crisis in confidence of small investors, Congress, I think, should act as long-term stewards of our economy, and work to rebuild economic confidence. That means by strengthening regulatory agencies: the SEC, the CFTC, the Federal Energy Regulatory Commission, and others. Now unfortunately, the tax cut, which was recently enacted, I think moves us in the opposite direction. I believe it's the wrong medicine. It doesn't put money in the hands of those most likely to spend it. It will do little to create new jobs. Instead, 57 percent of the benefits accrue to the top five percent of the taxpayers, and those people are gonna do what they're gonna do regardless. Now by 2010, the three tax cuts, which have been passed over the last two years, will lower the federal tax burden on the top one percent of taxpayers by 17 percent, whereas the bottom 20 percent of taxpayers will see a nine percent reduction. These tax cuts have made our tax code dramatically more regressive. Moreover, the uncertainly created by so many sunsets and phase-outs further detracts from any positive impact the tax cut might have.

Now I want to say something about the budget deficits because they are quickly approaching heights not seen in two decades. The new debt created by them I believe is going to squeeze federal spending for years to come and actually discourage further private investments. These deficits are neither small nor short term, as the President promised. Instead they are among the largest budget deficits we have ever seen and they represent a structural imbalance between revenue and outlays. Goldman Sachs recently estimated this year's combined federal deficit will reach 400 billions dollars, which means that the on-budget deficit will exceed 500 billion, or five percent of GDP. The federal debt is projected to rise from 6.7 trillion to 12 trillion in 2013. Now that's an amount that will force us to spend a much larger portion of the budget to pay interest costs.

I want to speak for a moment that I definitely believe that a better course would have been to have primed the pump in order to cut non-discretionary spending. To remedy this kind of structural deficit, we'd have to cut it by eighty percent or more. That's discretionary spending. Clearly, we can't dig out of this hole that way. A better course would be that Congress direct spending towards those areas that would create jobs. Each one billion dollars spent on transportation infrastructure creates forty thousand new jobs, and this yields tangible results. Any of us that travel to our economic competitors see revitalized economic infrastructure. The port of Hong Kong, where I spent a day in

December, is more modernized, moves containers faster, than virtually any port in America. It's highly computerized, takes some 30,000 containers a day; it is just booming, and other ports do the same. Our transportation systems are becoming outdated, our highways overcrowded, our schools decrepit. All of those things, you go to China and you see a brand new Maglev system from Poudong to the airport. These are the things, I believe, that we should spend more of our revenues on. I thank the Chair.

Senator Dorgan

Senator Feinstein, thank you very much. Congressman Spratt, the Ranking Member of the House Budget Committee.

Congressman John Spratt, Jr.

Thank you very much Senator Dorgan, I'll sit over here so I can get to the microphone a little better. First of all thank you for holding this hearing and letting me basically emphasize what both of you have just said. We're here because we are faced with an economy that has lost three million private sector jobs, and it can't be said too often. Just the last three months it appeared when we would think, looking at the history of post-war recession, the economy would be turning up; it's past due. The economy has lost 525,000 jobs; the unemployment rate is up to 6.1%.

That number by itself does not seem too shocking. We've had worse rates of unemployment in prior recession. But you need to look at that number and at the other indicators as well. For example, I can speak for my own district. I come from South Carolina, where we've seen textiles, furniture, tobacco and agriculture take it on the chin. And while these numbers are not fully reflected in the unemployment statistics, if you look at those who are working part-time, and even more at those who are under-employed, you begin to see the depth and severity of this recession and why it is it concerns us still this morning. If you also look at the number of people in that eight million total who don't have jobs now, who once had them, you'll find that twenty-two percent--twenty-two percent of the unemployed--have been jobless for more than six months.

If you look back at prior recessions, you'll also see a pattern that is not repeating itself in this particular recession. I have a chart here to show the point that I am trying to make, a very simple chart. This is a pattern from peak to trough and back to peak of prior recessions, and this down here, this trailing line that continues to decline, is the path of unemployment in this recession. It simply hasn't come back, which has to be a great concern to all of us. We've got an economy in which there is a deficiency of aggregate demand. That's the economist's definition of the recession that faces us. Today we have witnesses who will talk on both sides of that issue and we're glad to have Mr. Kemp here because he will speak to one side and the others will speak to another. Mishel, Mr.

Mishel in particular gives us an insight into this problem that I think we really need to spend some time analyzing and I hope our other witnesses will look at it.

Why do we have such anemic demand? Well one reason is, real disposable income is declining. One reason is household income is declining. And both of these underlie not just the 6.1 percent unemployment but also the persistency of this recession that I just pointed out on the chart that I offered.

So we have before us a problem that is a vexing problem and it has to be of concern to all Americans, Democrats and Republicans, and we've got to keep searching for solutions. We can't rest on the tax bill that was just passed and hope that it will come to fruition; we've got to keep monitoring this problem and looking for better solutions. I'm a skeptic that the tax bill will do what it was advertised to do. I think for a lot less revenue losses we could have done a lot more for stimulating this economy, and I know this because the Fed and lots of others tell us—as well as practical experience from past recessions and from past economic performance—for every hundred billion dollars that the deficit grows, there will be some impact—the Fed says in a recent study 60 basis points—on interest rates. And we're looking at a deficit this year that is likely to be over 400 billion dollars. Taking that formula literally, that's two and a half percentage points of interest that is bound to stifle whatever growth this economy is able to muster in the long run. That has to be a huge concern because the deficits we're dealing with today are not cyclical deficits. If you look at the upper line, the on-budget deficit excluding Social Security, which distorts the real number, you'll see when you factor in all likely future action, that the deficits we're looking at for the next ten years are over four hundred billion dollars and they are bound to have a stifling effect on growth in the out years. And both of those factors must concern us.

We want to stimulate the economy now, get it on its feet and running so we can re-seize those who are unemployed and give them full employment, but also lay the type of growth for the future they had in the 1990's. I look forward to all of your witnesses and I look forward to all of your testimonies.

Senator Dorgan

Thank you Congressman Spratt, Congressman Scott?

Congressman Scott

Thank you Mr. Chairman, senators, colleagues. I'm gonna use charts because I find that if you show what's going on rather than just try to describe it makes it a little easier.

This chart shows how we got to where we are and actually this chart is out of date because the red ink on the right has actually gotten worse than it was projected to be last February. But you'll see in the green what happened in the Clinton administration when we in fact did dig ourselves out of the mess. We got all this red ink by giving tax cuts, as was already commented, by giving tax cuts which will essentially help the wealthy. This is by percentiles. You'll see a line at about the fifty percent mark, which shows that half of the tax cuts are going to the upper one percent, but the vast majority of the upper twenty percent. To put it in numbers, this is, by amount of income, and you'll see on the bottom, and you'll have to hold that up because I don't think people can see that, and you'll see that if you make more than a million dollars you're off the charts.

We were told we had to give these tax cuts to run the budget and create jobs. This is what happened, this is the number of jobs created from by each administration, back to the Truman administration, and you'll see that after we made that tax cut and ruined the budget, over two hundred million jobs lost.

You can't blame this Mr. Chairman, on 9/11, because this chart includes both the Korean War, the Vietnam War, the Cold War, the hostages in Iran, the Persian Gulf War, and still this is not just below average, this is the worst since the Truman administration. Now we shouldn't be surprised at that, because at the next tax cut we've been told that we're going to create 1.4 million jobs, if you read the rest of the report, the deficit we're going to run up will actually creates problems long term, so that although you may create four million jobs in the election year, in just a few more years after that you will have lost all of those and 700 thousand more.

The next chart shows the same pattern, the joint committee on taxation shows not exactly the same numbers but the same patterns, at best you're going to end up with what you started off with if you passed this stuff, on average you're going to be a lot worse off. Now when you run up all this deficit, you'll run up debt. And debt is not free you have to pay interest on the debt. This chart shows in green interest on the national debt that we were going to pay, if we continued going with the surpluses and paying off the debt, the red is the interest on the national debt that we're going to have to pay, and to put it in perspective the blue is the amount we pay on the defense budget. We're gonna be paying as much interest on the national debt as we are on national defense. To make the debt tax personal we divided the interest on the national debt by the population and multiplied it by four, and found that an average family now is paying 4,500 dollars in interest on the national debt. It was going towards zero—by 2013, 8,500 dollars on the national debt. As that interest on the national debt for a family of four is going up, we have unfortunately, the Social Security crises.

This is a cash flow on Social Security. We are now enjoying a hundred dollar surplus. And you can see the red ink, over a trillion dollars in national deficit that we're gonna have to pay. The really egregious thing about this thing, is that if you've taken just the part of the tax cut in 2001 that went to the upper 1 percent, that amount out money, put into the Social Security trust fund, would have been enough to pay Social Security benefits for the next 75 years, without any diminution in benefits.

That kind of puts things in perspective, Mr. Chairman, in a way I hope people can understand.

Senator Dorgan

Congressman Scott thank you very much and finally Senator Pryor.

Senator Pryor

Thanks Senator Dorgan, I just have a few brief comments to make. One is that, when I was home this weekend in Arkansas, I read again in our statewide paper, that there are some manufacturing plants shutting down, and/or, laying off people there in Arkansas and of course that's true all across America. I noticed that the Labor Department that manufacturers have cut jobs in May for the 44th consecutive month. And that's a very disturbing trend. And its something that, my concern is, we talk about this economy, I heard some people say, that there is a recovery going on its just a jobless recovery. I have a lot of concerns about a jobless recovery that doesn't sound like much of a recovery to me in fact it seems like we can't sustain that for very long.

Also I noticed in the labor department that now that unemployment is now at 6.1 percent in May, that that's the highest level in 9 years. The economy has now lost 2.5 million jobs since February 2001. That's the longest period without sustained job growth, since WWII. This is a very serious situation.

Mr. Chairman, what I'm concerned about, is when we look at this administration, even though I'm very committed to working with the other side and certainly with this President and administration any way I can, to get the economy moving again, in fact I think that's one of the reasons I was elected to this post is because I talked about that in my campaign with coming up with meaningful solutions. The thing that really does concern me is that this administration doesn't have an economic policy. When I say that, what I mean, is very simple. Their economic policy seems to be that, if we cut taxes, that will stimulate the economy. But what I think we all know from past experience is that tax cuts can be part of a very solid part of an economic policy. But it's only a part of the policy. And what we need to consider is targeting some spending, we need to consider certain programs to stimulate employment, we need to consider the increasingly enormous cost of health care.

There are a lot of things that we, as policy makers, including the President and the White House, should look at, to provide a meaningful economic stimulus. But what I'm concerned about is that now we, as the charts indicate on the national debt and national deficits that will be generated, in some measure, due to these tax cuts but there are other factors of course, is that we're not gonna have the money in our budget to stimulate the economy. We just don't have the resources, anymore, to do this. I'm concerned about what I see in Washington but more importantly I'm concerned about what I see in America. So, thank you for having this.

Senator Dorgan

Congressman Pryor, thank you very much. The first panel that is joining us this morning is a very distinguished panel, if I may ask, Mr. Kemp and Mr. Reich to please come forward. As they do that, let me read their biographies. I won't read their entire biographies. They're so distinguished it would take some while.

Robert Reich is the university professor and the Morris B. Hexter professor of social and economic policy at Brandeis University's Hillard Graduate School, Founder and National Editor of the AMERICAN PROSPECT. Mr. Reich served as Labor Secretary during President Clinton's first term, on the faculty of Harvard University's John F. Kennedy School of Government, author of nine books, has been part of a four part public TV series entitled "Made in Amercia," radio commentary on PBS. Quite a distinguished record we appreciate having you here.

Jack Kemp, founder and co-director of Empower America, it's an organization ensuring that government actions foster growth, economic wellbeing, freedom, and individual responsibility. 1996 Mr. Kemp was the Republican party's vice presidential candidate, he served as Secretary of Housing and Urban Development during the first Bush Administration, prior to that he served Buffalo and New York for 18 years in the U.S. House of Representatives, I was pleased to serve with Congressman Kent at that point. He spent thirteen years playing professional football, playing quarterback for San Diego and the Buffalo Bills, AFL championship twice.

Let me thank both of you, you both have a very distinguished public record and I appreciate very much the opportunity to have you discuss jobs.

Before I ask you to speak let me just say for a moment I was on a radio show recently and some woman called in and said well, you all I'm sure want the President to fail, because if he succeeds you'll look good. I said 'Oh to the contrary I very much want the President's plan to succeed, if it succeeds we'll expand jobs and opportunities in our country, I don't hope at all that it fails, if it does not succeed I want to know what the alternative strategy is so that it can succeed. We all have an interest in having this economy move forward, expanding opportunity for all Americans. And so we all want the same goal, we have different visions perhaps on how to achieve it, but we all want the same goal for this country. Having said that let me thank you for coming, Mr. Reich would you like to begin?

Mr. Reich

Certainly, Mr. Chairman. Thank you all. The issue of jobs is at the forefront of most people's concerns and minds right now. Certainly in your districts and states and certainly as I travel around the country, I hear people saying, 'I am scared. I am on the verge of losing my job, or my brother in law or my sister in law or someone else has lost a job, but our costs of living, right there, are continuing.' And the question that we are all asking, and Senator Dorgan Mr. Chairman thank you for putting so eloquently what I think we all believe and what I think we all care about how to get this economy moving—it is not a partisan issue, it should not be a partisan issue. We all have a stake in making sure that all Americans can succeed, pay the bills, and prosper. Now there are two separate challenges facing the economy and its important for us to keep them separate in our minds because I think many of the discussions that I've heard about the national economy confuse the two. And for the purpose of elucidating the issue and making people understand what's at stake, let me separate them.

The first is a problem of inadequate demand. As some of you have stated already we have a lot of capacity in the United States and in other parts of the world that we don't have enough demand for all the goods and services we can produce. People don't have enough money to buy all the good and service that we can produce. Factories are running at about 70-73 % capacity, a lot of equipment is idled, and most important and most disturbing, we've got 8.5 million people who are jobless and millions more who will become jobless or who are working part time and would rather be working full time or people who have given up all together, people who are no longer appearing in the unemployment statistics because they are no longer looking for work.

How then, in the short term, to stimulate the economy; that word stimulus. That is about increasing demand, making sure there is adequate demand for all of this capacity. Now we've had a tax cut, a tax cut that members have adequately described as benefiting mostly people who are of very high income. Now quite apart from issues of fairness, the problem with giving tax cuts to people who are wealthy, is that they are not going to spend the extra money they get on goods and services in the economy. The definition of being rich is that you're already spending as much as you want to spend. If someone who is earning millions of dollars is getting 93 thousand dollars, getting back that tax cut is not going to go into more spending. That person is maybe going to save, or maybe invest, but that's not spending, that's not going to stimulate the economy.

And similarly, if a corporation gets some tax benefits, that corporation right now is not going to use those tax benefits to invest into the economy, to spend more, to go to suppliers and spend more. The corporations these days already have as much as they want to spend. Low rates of interest, low borrowing costs, lower than we've seen historically in over twenty years. They are going to get very, very cheap capital, they can do all of the investing they want, they are not going to do it until they know that there is adequate demand for the goods and services that they produce. Now if consumers are not going to do it, because they can't spend as much as they need to spend, they're not making the kind of money they need to make, and if corporations are not going to do it because there's not adequate demand there for the goods and service they produce, government has got to be the spender of last resort to again stimulate the economy.

As many of you know the states are in desperate fiscal straits. In schools all over this country, budgets are cut, class sizes are expanding, after school projects are being cut, transportation projects are being cut. One thing that the federal government ought to do that the federal government isn't doing, would be to engage in genuine revenue sharing with the states, and help the states deal with the fiscal crises. What is happening at the local level is that social services, schools, critical social projects such as transportation for the poor, several of them are being cut. That is acting as a fiscal drag on the economy; that is reducing demand.

What we ought to be doing is helping the states. In addition, we ought to be implementing a tax cut for average working people. You know, 80 % of Americans pay more in payroll taxes, than they do in income taxes. And yet you know, as well as I do, that the payroll tax is quite regressive. You pay payroll taxes on your first dollar, you pay up to, about 88 thousand dollars and then you pay nothing. If you're very wealthy, you stop paying payroll taxes at the beginning of the year, but if you're an average working person than you pay payroll taxes throughout the year. One way to get money quickly into the hands is to provide a holiday, maybe one year, from the payroll tax, so that average working people have more so they can go out and spend. Again, the short-term issue is demand. Government, both spending directly helping the states, and also government cutting taxes on average working people putting more money in their pockets so they can go back and spend. Spending in the short term is critical if we're going to get this economy going.

When will get the economy going again we don't know, but Isaac Newton's reverse law does apply to the business cycle. What goes down eventually comes up. We don't know if the economy will start really reviving in six months eight months, a year, this is an unusual recession, most recessions do not last this long, most recessions are not characterized by the kind of technology bubble implosion the problems we've seen in corporate fraud and terrorism. Consumer confidence is rising, but unless there's a genuine stimulus this economy is not going to revive any time soon, and jobs are not going to come back any time soon.

Now if the committee will allow me to talk briefly about the second problem because I think this is where the confusion will come in terms of understanding the President's new tax law, and I'm very interested in hearing Jack Kemp's response to this because I this is really a supply side initiative. I don't think this new tax cut has much to do with a new tax cut at all. Alan Greenspan has said as much, most economists agree, that this is not a stimulus tax cut. Now what conservative supply-siders have said--what the President has said--is about giving wealthy people incentives to save and invest and build the capital stock of the United States.

We're talking about physical capital for the long-term future so that we can grow faster. It's not a stimulus it's a long-term growth plan based of the principles of supply side economics.

Now it is true that we do have a long-term growth issue. The only way we're going to pay for Social Security and Medicare, the only possible way we're going to pay for defense needs and homeland security, the only way we're going to pay for what our children need, schooling, and healthcare, and all the rest, is if we grow faster. We are not going to grow faster through the nostrums of supply side economics. It was tried in the 1980's. I can tell you as a member that went to office in January 1993, when we had 300 billion dollar deficits as far as the eye could see, when the only way of getting the economy back on track was by getting some fiscal responsibility back, because the Reagan and first Bush administration had driven us into a fiscal crises, and we had a deep recession on our hands, I can tell you that over the long term, supply side economics does not work. They say it trickles down to people in the bottom and to people in the middle class; it does not trickle down. It is trickle on. The only people that benefit are the people at the top. And you end up with huge deficits in the future.

Now I'm proud to be a member of an administration in which we presided over an economy that created 22 million net, new, jobs. We got that because we got our fiscal house in order, and because we invested in education, and job skills, and transportation. And that is the essence of what might be called a democratic supply side economics. We do have to invest. But public investment, in education, training, transportation, and health care, those investments that make our people more productive, are the crucial investments we can make in the long term.

We are in a global capital market; money goes everywhere. Your savings, my savings, and everybody's savings will go anywhere around the world where they can get the highest return on their investments. The critical issue is not to increase savings, the critical issue to make our people more productive so that global savings will come here and generate good jobs.

The one resource we have here that is uniquely American is not our factories, our equipment. Not our money, not our technology--because those are going all over the world. Senator Pryor, your factories in South Carolina, they came from New England originally, and a lot of those companies where did they go? They're going to Southeast Asia. Capital is footloose, but what is not footloose is the capacities of our people to be productive in the future. So if don't invest in education, in our K-12's, our public universities where are now being cut to ribbons, if don't invest in good infrastructure, good public transportation, if we don't invest in research and development here in the United States, if don't invest in people's capacities to have healthy lives so that they can be productive, we are not going to be a prosperous nation in the long term.

So just to summarize: the short-term problem is that we need a real stimulus to get the economy back on track. The long term problem is that we need a form of supply side economics but not having to do with financial capital or physical capital that is going around the world, it has to do with our unique supply of people, Americans and their capacity to be productive. We have to invest in people over the long term; we are not doing that now.

A tax cut that benefits the wealthy, not only fails to stimulate the economy, but it also fails to provide us with the funding that we so critically need, to invest in our people. Thank you all.

Senator Dorgan

Mr. Reich, thank you very much for your testimony. And next we will turn to Mr. Jack Kemp. Jack, thank you for being here.

Mr. Kemp

Thank you Mr. Chairman. First of all I'm not here to represent the administration. I think you might have invited someone...

Senator Dorgan

We did in fact we invited the head of the Council of Economic Advisors for the administration.

Mr. Kemp

And, they're not here.

Senator Dorgan

They're not here. But we're pleased you're here.

Mr. Kemp

I have great respect for your party Mr. Chairman appreciate the chance to be with you, enjoyed the comments of my colleagues and my former colleagues, and former Secretary of Labor, Mr. Robert Reich. You've heard from a democratic supply-sider, now you'll hear from a real supply-sider. I want to congratulate you on the courage of your invitation. You know I've been called a voodoo economist, a Witch Doctor, a slimy dangerous riverboat gambler, and that was just coming from my own party!

And today, all sorts of things might be said and as I said I have great respect for your party we need two great parties. We need to compete in the field of ideas and I admire you having these hearings and inviting someone from the other side so to speak.

Six-point-one unemployment is an abomination. Secretary Reich mentioned and I know Congressman Scott mentioned the number of men and women looking for jobs. Some have given up, and as I said its an abomination in a country as great as ours, and as wealthy as ours, to tolerate the level of unemployment that we have today.

The president, say what you want about his tax bill, has taken action. In my opinion, he shares our premise. How do we get America growing again? I'm not an economist, as you mentioned I played professional football, I was a quarterback, and I have never been satisfied with the status quo. Never. And I learned one very important lesson of economics from my father, and small businessman from Los Angeles back in the 1940's and 50's. You can't create employees, I know this is a profound economic premise, it may sound simplistic but I will say it from the bottom of my heart—You can't create employees without first creating employers. My daddy drove a truck, saved his money, invested in buying the truck, and thus making a profit, bought another truck and hired a truck driver to buy the second truck. Truck drivers' wages are higher when they've got trucks to drive.

How do we create more truck drivers and more truck owners? By lowering the cost of capital, and lowering the cost of labor, you will get more of it, i.e., more labor and more capital.

I want to quote Jesse Jackson. I'm the only Republican certified by Jesse himself, to quote Jesse Jackson. He said, "Capitalism without capital is just an ism. It's an abstraction. And the lack of access to capital is the single biggest problem for minority men and women, for many of our urban areas of America. And Kweisi Mfume, to the publisher of Black Enterprise Magazine, Earl Graves, the single biggest problem in the minority population is lack of access to capital.

Now, by lowering the cost of capital, and by lowering the cost of labor by lowering the tax rate across the board I believe that president Bush, albeit wouldn't say the way Jack Kemp says it, has increased the rate of return for working, and for investing, and with all due respect to Mr. Robert Reich, the problem is not just a lack of demand, the problem is that which he alluded to, is getting a higher rate of return. He said, 'Capital goes where it gets the highest rate of return.' By lowering the tax rate on the formation of capital, i.e., creating a higher rate of return on investing, and working, in my opinion you'll get more work, more labor, and more capital formation.

I did not learn my supply side economics from Arthur Laffer of California, or Robert Mundell the Nobel Prize winning economist, I learned it from reading the speeches of John F. Kennedy in the 1970's in when unemployment in Buffalo was 17%. Great speech, Mr. Chairman, circa 1962, in a New York economic club speech when President Kennedy in my opinion laid the predicate for personal and corporate tax relief by arguing that, "Next year's tax bill, must reduce the personal and corporate income taxes for those in the lower brackets who are certain to spend it, and those in the middle and upper brackets who thereby would be encouraged to undertake additional effort and are enabled to invest more capital." He said third that the "new tax bill should improve both the equity and simplicity of our new tax bill. Well no one argues about simplicity today, its too bad, because simplicity has gone out the window. But nonetheless, his tax rates cut income tax rates and corporate tax rates 25%, cut capital gains tax from 49% to 28%. I don't know what percentage that is but indeed that is pretty large. Indeed, President Clinton cut the top capital gains tax from 28% to 20%, in fact I gave President Clinton the other night at a dinner we both attended, a copy of John F. Kennedy's speech and asked him to read it because frankly I don't think you're great party, for whom I have great respect, really have read the words and works of John F. Kennedy who as I said earlier cut the top tax rate by 20% and cut the top capital gains rate and cut the corporate income tax.

With all due respect to my friend Robert Reich the choice is not, as Kennedy said, between tax reduction on the one hand and the avoidance of a large deficit on the other. He said that it is increasingly clear that no matter what party is in power, so long as our national security needs keep rising, and I think most people would agree now that our homeland security and defense needs are rising, an economy that is hampered by restrictive tax rates cannot produce enough revenue to balance our budget just as it will never produce enough jobs or enough profits. He said the lesson of the last decade is that deficits are not caused by wild-eyed spenders, as Republicans would say; it's caused by slow economic growth. And periodic recessions and any new recessions would break all deficit records. He said it's a paradoxical truth, that high tax rates create low tax revenues, and the best way to get more revenue, is the cut the tax rates.

Look, you can say well times are different. Well, yeah they are. You can say that George W. Bush is not Kennedy, and you know, he's not. And there are totally dissimilar economic circumstances in the world. Clearly, lowering the top tax rates, and cutting tax rates across the board and accelerating those rate reductions and attempting to lower the double taxation of dividends, and cutting the capital gains tax and I would have preferred that we had suggested increasing the low income tax credit immediately, even though that's heresy in some parts of my party, I believe that President Bush has wisely, and fortuitously, and with audacity, is bringing down the tax rates on those men and women who will work and save in the future economy to get it growing again.

Last point, all these young people back here need to keep something in perspective, as I think members of congress do. Harry Truman was mentioned, and he's one of my real heroes, particularly after reading the book by McCullough, the debt coming out of WWII was 144% of GDP. I don't know what it exactly is today but its somewhere around 40-41%. The deficit coming out of WWII was 41 % of GDP. Our deficit has to be measured against the size of the economy. 400 billion sounds like a lot of money, particularly to these young men and women seated behind me, they should also be told that the size of the economy is about 11.1 trillion dollars. The debt of the country over ten years, is huge, in abstract terms, but its measured against over ten years, over 140, 150 trillion dollars.

With all due respect Mr. Chairman, when I played for the Buffalo Bills I made 50 thousand dollars my wife and I bought a home for 150 thousand, with a mortgage of 125 thousand. Jim Kelley, followed me, made 5.1 million dollars a year and had the same mortgage on his house that I had on my house. I was making 50 and he was making 5 million and we both had the same mortgage, and it was huge to me, I doubt whether Jim Kelley thought it was huge to him. Please, when talking about debt and deficits measure it against the size of the economy against the size of the revenues that are going to come in and if we can get this economy growing again in bipartisan ways, in my opinion, it is the only way to finance Social Security, healthcare, education, or whatever else we want to spend.

Dianne Feinstein, with whom I've been friends for a long time, mentioned Hong Kong. I think we should tell all these people that the Hong Kong tax code has a flat 15.5% income tax, no tariffs, no duties, no barriers to investment and a 15.5% income tax: they attract income tax. They can spend a lot of money on transportation because they have an influx of capital from men and women who are anxious to work and save and invest in Hong Kong. I said this one time in Florida and somebody said well 'that's because they're Chinese.' I said, 'there aren't people on the mainland? There are people living in abject poverty in China. If you reward people in for investing and saving and working, you'll get a lot of it. Thank you.

<u>Senator Dorgan</u>

Mr. Kemp, thank you very much. Let me please ask first a quarterback question if I may, and Robert you're not a quarterback but I suspect you'll be able to answer this question as well. A quarterback I assume, when calling plays, if he calls a play three times and it doesn't work he changes the play in the huddle the next time, doesn't call the same play-

<u>Mr. Kemp</u>

Touché

<u>Senator Dorgan</u>

So the question is, when will we know, whether the play that's been called in fiscal policy works? My colleagues held up a chart that shows we've lost 3.1 million jobs in recent years, which is unusual. If we've lost 3.1 million jobs and the President's budget says if we get the growth that he wants, he will double the debt from 6 trillion to 12 trillion, this is his number not mine, if everything works the way its suggested to work, and this report that I've mentioned from an assistant secretary of treasury, says we face a 44 trillion dollar liability, again a big number-

<u>Mr. Kemp</u>

Over how many years?

<u>Senator Dorgan</u>

It’s an unfunded liability in constant 2004 dollars?

Mr. Kemp

Over how many years?

Senator Dorgan
It’s a present value of our liability. The point is this: If we have this play called, and you’re quite correct, it’s the president’s plan, he won two years ago, he won this time, when will we know if it works and if it doesn’t work, and what will the evidence of that be in your judgment, I will ask first Mr. Kemp and then Mr. Reich.

Mr. Kemp

Well again, the 44 trillion dollars I think, correct me if I’m wrong, is measured over the rest of the century. If you’re saying we have to get the economy growing again I totally agree, but when will know it works? Well Jack Kemp would have done the tax cut differently, but putting aside that, we’ve gone through a horrendous, in my opinion, deflation. The dollar, from 1997 to 2001 rose over 45%. A rising dollar, and falling prices, is clearly a deflation in my wing of economic policy. People with dollar denominated debt, many of the people that Senator Feinstein represents in technology and telecom, and third world country’s who had dollar denominated debt, were paying back their debt, which was huge, in dollars that are appreciating and severely hurt the United States’ economy, in my opinion, hurt silicon valley, and it is still occurring in Japan. Interest rates are less than one quarter of one percent and there have no recovery. Guess what? Their tax rates are too high. My solution to everything is not cutting taxes I don’t think cutting taxes can stop intercontinental ballistic missiles, though some people have accused me of suggesting that, but clearly the tax rate in Japan is way too high, and I think that Bush is correct in lowering tax rates to help get America moving again. For the very same reason President Kennedy used it in the 1960’s and Reagan in the 1980’s, and with all due respect to Robert Reich the eighties expanded this economy in incredible levels of employment, jobs, and entrepreneurship for women, minorities, people of color generally, and quite frankly I think its time to do it again.

Senator Dorgan

Mr. Kemp what I’m asking is if for example we see, 24 months from now, we see a continued erosion of jobs would that suggest that this fiscal plan needs to be modified or doesn’t need to be modified?

Mr. Kemp

If it goes up in the short term I will be very surprised. The tax rates, in my opinion, are too high, they're coming down, they're retroactive to January of this year, and it doesn't matter if Kemp or Dorgan or Reich or Feinstein or anyone else in this room believes, it is going to be registered in the marketplace of ideas. President Bush could not get reelected in a recession, in my opinion. Nor could his Daddy, nor could Reagan, nor could Bill Clinton. I give high regard for the economy of the 90's, but it all started, frankly, in the 80's with our tax rate reductions.

Mr. Reich

Well I have the highest regard for Jack Kemp, but he's wrong. With regard towards how we tell whether this particular house cut is a success, let me say the President has set the bar remarkably low. He has said that the tax cut will result in 1.4 million jobs between now and the end of 2004. Well, without the tax cut, if The Whitehouse did nothing, if The Fed did nothing, if everyone simply sat on their hands, it would be a miracle if 1.4 million jobs were not created. What we know about the business cycle is that once the economy reaches the highest level of unemployment, and lets hope that 6.1% is the highest, it could go higher. Lets hope that 6.1% is the highest. We know in the months after that, the sixteen, or eighteen, or twenty months after, that in typical recoveries, you've got a job growth averaging 250,000 jobs a month. And that's with nothing done. That's with no tax cut at all. So the President's goal of 1.4 million jobs by the end of 2004 is not really a goal at all. This economy has been generating over the long term, if you simply take a baseline over 2 million jobs a year, recession or no recession that is the average. If it's only 1.4 million jobs we are failing miserably.

Senator Dorgan

Mr. Reich, let me ask you and Mr. Kemp another quick question, after that I want to turn to my colleagues. It seems to me we already have monetary policy that is extraordinarily stimulative. We have fiscal policy that is extraordinarily stimulative already, somewhere around four-billion-dollar deficit spending in the current year. If you have both monetary and fiscal policy that is already stimulative and you have on the side a trade policy, which neither of you have mentioned, Republican and Democratic trade policy that sounds alike and essentially is alike, that is producing the largest trade deficits in history. Tell me how, tell me how the federal government does more to stimulate confidence through fiscal, especially fiscal policy, we really don't control monetary policy, fiscal and trade policy what do we do specifically to try and instill some confidence at this point; because you heard my opening statement I think this is much more about confidence than it is about specific fiscal policy. If they're confident in the future people do things that manifest the confidence and that's the expansion side of the economy.

Mr. Reich

Mr. Chairman, in the short term, and again we're talking now about the stimulus, and I want to emphasize that because the debate that Jack Kemp and I had a moment ago was about long term economic growth, not the stimulus. If we're talking only about the stimulus you are absolutely right that The Fed has done almost everything it can do. It's brought interest rates down twelve times, I suspect, now, I have no inside knowledge but I suspect that on June 24 or June 25 we'll see another rate cut, but the federal government also, by putting money in people's pockets and also helping the states, with their fiscal crises, can provide more stimulus and a stimulus that actually helps average working people. Now when I talked in my initial discussion with you about the states' plight right now, we're talking about 80 to 100 billion dollars of fiscal drag. States are cutting programs and raising taxes because they are in deep trouble. And almost every state except one has got to balance its budget. The only way states are balancing budgets is by raising taxes and cutting services. That's a major fiscal drag. The federal government can help the states out. The federal government can also help average working people who are getting almost nothing out of this tax cut. Average working people are getting, the studies show, anywhere between eighty and 150 dollars. That is nothing. That is not going to help them; that is not going to stimulate the economy. Now reference has been made to John F. Kennedy's tax cut and let me just for the purposes of setting the record straight make sure that we all recognize that the top marginal tax rate at the start of the Kennedy administration was 90% and he reduced it from 90% to 70%, the top marginal tax rate. That is nothing, nowhere near what we are doing now. We are reducing marginal tax rates on the top from thirty-eight down to thirty, a little bit over thirty, but actually given that it's a 15% marginal tax rate now on dividend income and on capital gains income we're going to see the effective marginal tax rate far below that on people with the highest incomes. This is no analogy at all with the Kennedy administration.

Senator Dorgan

Mr. Kemp.

Mr. Kemp

Yeah. Very interesting. The top tax rate was ninety; it came down to seventy; Reagan cut it to fifty (Kemp-Roth). It came down to twenty-eight by the end of the 1980's. President Bush one allowed it to go up and I think that was unfortunate. I don't know what the top tax rate would be or should be really, it's a subject of debate, but it ought not to be fifty or forty-five. Living in California the top tax rate probably is close to fifty. New York is fifty; the top tax rate at the margin where people have their surplus capital and trying to make a decision whether to consume, save, spend, or invest. So that's, you know that's that straw in my opinion that is breaking, or is hurting the camel's back. What it should be, as I said, Hong Kong is fifteen point five, Putin in Russia cut it to thirteen; revenues are going up the underground economy is going down, it's not a cure all, but I think how you tax surplus income is very important. It's very static to analyze the tax cut by saying that it's going from 350, or 450, or 500 billion. Actually the top tax rate is thirty-nine point six, it's going down to thirty-five. I don't know what percentage that is but it's not egregious. The rates are going down, as President Bush suggested across the board. And when Robert Reich was Secretary of Labor, correct me if I'm wrong now, President Clinton signed into law a 30% cut in the capital gain tax, for the rich, I guess. But make no mistake about it; you can't get rich on wages. You have to get rich after taxes by earning and investing. So by punishing the formation of capital, or the raising the tax on capital gains, in this case President Clinton who I saw the other night and I congratulated him for signing a Republican bill, look what happened to revenues. Revenues went up under Clinton because we had growth. The growth of the economy is the number one issue. In 1996, the last year with the 28% capital gain tax, the government collected 60 billion dollars in capital gains revenues. In 1998 and 1999, each year, the government took in 110 billion dollars in revenue. If we want more revenue, take the rates down on those who are willing to invest and put their surplus income at risk. And I would make a case; you can't go to zero because there's no revenue at zero. But you can't keep going up and up because eventually people will take their capital off shore or buy shelters. And if you tax, if you really want to soak the rich get the rates down across the board, and I would suggest, hopefully, we get the top tax rate down to where Maynard Cain said it should be in a peaceful world at 25%. He said no tax in peacetime should be above twenty-five percent; we're close to fifty. I live in Maryland; my tax rate is close to 45%.

<u>Senator Dorgan</u>

But it is not a peaceful world. We are spending 400 billion dollars a year on the military. We have Social Security. We have Medicare. We have huge, huge expenditures coming up.

<u>Mr. Kemp</u>

I agree with that, let me finish my statement Mr. Chairman. I too want more revenue. I have never been a Milton-Friedman advocate who said cut taxes anytime, anywhere so that we can get spending down. I want to get the rates down so we can have a bigger pie, more jobs, and more revenue. So if you want to finance spending, no matter whether it's for defense, or social policies, or both get the rates down to where people are willing to work and invest.

<u>Senator Dorgan</u>

I have exceeded my time but let me make one comment and then I'm going to call on Senator Feinstein and you may answer, Mr. Reich, under Senator Feinstein's time. My grandfather was a big boxing fan. He had a subscription to Ring magazine, Nat Fleisher, and so on. Back when Rocky Marciano was the heavy-weight champion from Brockton Massachusetts, my grandfather explained to me when I was a little boy, well Rocky

Comment: Check spelling.

Marciano fights only once a year because Al Wyle his manager says that if he fights a second time, tax rates were 90%, if he fights a second time he only gets ten cents of every dollar the government gets ninety cents. So I'm not unsympathetic, Mr. Kemp, to your proposition. There are rates that retard growth, alter people's behavior, and so on. I understand that, I wanted to tell that story just to make the point. I also want to say, I hope you will both respond to this as you continue, there are people in this country who take a look at how this fiscal policy adds up, facing some very significant problems in the out years when the baby boomers retire and say there isn't any way we can confront this mountain of obligation with this fiscal policy. And because that provides a lack of confidence in people about the future, that in itself retards growth, retards expansion, retards opportunity. I'm just saying that's a school of thought out there. I happen to feel that there's some merit to that and I'd like both of you to respond to it if you will in future questions. Let me call on Senator Feinstein.

Senator Feinstein

Thanks very much Mr. Chairman. Jack, I wanted to ask you this, I am increasingly concerned about the concentration of wealth in this country. I know many people in the investment area, from California or nationally, not one has ever said they need a tax cut. Not one has ever come up to me and said they need a tax cut. A while back I called the California franchise tax board and I asked this question, how many families earning over 200,000 dollars a year are there in California. We have 36 million people; at the time we had 13 million income tax payers. You know what the result was? About 250,000 of this huge state, sixth largest economy in the world, there are only 250,000 families that make more than 200,000 dollars a year. An enormous concentration of wealth in much of California, in many areas is now beginning to look like a third world country. The jobs that are produced are low, low-income jobs and people can't live on them. And those 700,000 or so that are on minimum-wage jobs have to have three to be able to break even. It is a terrible problem out there. This tax cut adds to that concentration of wealth. I know what the upper 1% gets in that $90,000 tax cut. This, the public policy ought to be directed to bring everybody up. To enable everybody to be upwardly economically mobile and this tax cut fails so dramatically on this score. Now you mention that the purpose should be to enable business to gain capital when business needs it. The problem is many businesses that need that capital are deeply flawed in our country through a lot of practices that have grown up through years and times highly leveraged companies, et cetera et cetera. So I don't think the problem is going to be solved through this tax cut and it concerns me very deeply because its only going to serve to concentrate the wealth more widely.

Mr. Kemp

If you take your premise to its logical conclusion you're right. You're arguing logically from your premise, which is in a static analysis 95,000 dollars, less tax on Larry Ellison of Oracle, upon whose board I proudly sit. I could care less about Bill Gates, or Tom Wiesel, who is a friend of yours, or Larry Ellison.

Senator Feinstein

That's not my point.

Mr. Kemp

We're not cutting tax rates for business to get them to invest, we're increasing the rate of return for taking your surplus capital and putting it to work. Because Byron Dorgan mentioned that when his father talked about Marciano fighting twice in Boston, or in the boxing ring twice a year he'd get a return of ten cents on the dollar, it doesn't make any sense.

Senator Feinstein

Do you believe Larry Ellison wouldn't buy this new company if it weren't for the tax cut? No way did the tax cut play a role in that.

Mr. Kemp

That's a business decision and in my opinion had nothing to do with the tax cut of George Bush.

Senator Feinstein

Exactly.

Mr. Kemp

In my opinion, you'll get more revenue from wealthy people by getting the rate down. That's why I want to cut the rate. I believe that too much surplus income is going to uneconomic rates of return and my opinion is that that was true under Kennedy with all due respect to the fact the facts that Robert Reich correctly quoted. It was true of the Reagan tax cut. It was true of the Coolidge tax cuts in the 1920's. Get the rates down so that you can get more revenue for the things that we want to do. If you eliminated the capital gain tax in America, in my opinion, which is a stupid tax, it is a tax on risk taking. If you eliminated it you'd lose revenues from capital gain taxes, but you would gain revenues from employment, from labor, from the businesses, and new start-ups. So look, I've gone beyond the Bush tax cut to eliminating the capital gain tax but I introduced a bill to eliminate the capital gain tax in urban areas of America on the radical theory that if you made the reward for investing in south-central Los Angeles, or in north Philly, or New York, or Chi-town you'd get more entrepreneurs putting their surplus capital into those areas and right now, Senator Feinstein, the tax on investing in California is not worth the return.

Mr. Reich

Anyone in Massachusetts and around this country has basically said well politics is not my sport anymore. It's not my game; it's not something that responds to me. It's a rich person's place. Now let me just respond if I may, to something else that's come up. Because we have a global capital market, because money and investment can go all over, and will go all over the world, seeking the highest return.

There are only two ways we have in this country for attracting global capital. And when I say global capital I mean your savings, and my savings, and everybody else's, it's all one big pool. It's going wherever the highest return is available. One way is the highroad. That is, we say to global capital, come here, create good jobs, because we have the most productive people in the world. They are productive because we've got great infrastructure, great education, great health care; they're a healthy people, they're able to be productive.

The second way is the low road. We have inexpensive labor. We have no environmental regulations to speak of. It is so cheap to do business here; you can do it cheaper here than you can in Bangladesh. Come here because you can get a high return on investment because we're so cheap. But that low road there's no end to it. It does not generate high living standards or prosperity. 70% of the cost of business is labor. Jack Kemp talks about reducing wages; well that's not the goal here. The goal here is not economic growth per se the goal is prosperity for more and more of our people. We're turning on its head the logic if we say the only way to get growth is to reduce wages.

Mr. Kemp

One second. I didn't say reduce wages. Can you find in my testimony anything I've said…I don't want wages to go down; I want wages to go up after taxes.

Senator Feinstein

You said lower the cost of labor.

Mr. Jack Kemp

Lower the cost of labor means making it cheaper for a business man or woman to hire and part of his or her cost is the cost of the payroll tax, cost of income tax rates. So if you lower the tax rate you allow people to hire more workingmen and women, so I do not want to lower the cost of the wages of working people.

Senator Feinstein

Let me just correct one myth and that is that people aren't coming to California. To an extent I wish that would taper off. California has increased population in the last four years by about 600,000 people a year. We are still predicted to be about 50 million people by 2020. So people are still coming. Whether they can succeed or not is really the question that we have to help them with. But my second question was this, and Alan Greenspan said this, and that is something new has entered the workplace and it's really an uncertainty and a fear on the small investor. Things have happened out there that have never happened before that I've seen. People have lost their retirements. Whole major corporations have collapsed. The level of fear and the level of uncertainty when added to the global situation create an atmosphere in this work climate that is totally different from anything in my lifetime. What do we do to reverse that? Now see, I think, for example, the Martha Stewart perp-walk is counter-productive. I know they want to send a signal, but I think it's absolutely counter-productive. Now everybody is will Martha Stewart omni media be able to survive. That adds to the fear and uncertainty. Because there's nothing wrong with our economy out there if it can just grow and produce again. I don't think there's anything really structural in the economy that's wrong, but every week there's a new story. Every week there are new accounting scandals. Every week the transparency of companies is being challenged. I think that has to take place and I'm for very strong enforcement. On the other hand, I don't think scaring the American people helps rebuild what we need to rebuild. Could you comment on that?

Mr. Reich

Senator, undoubtedly during the late 1990's huge numbers of Americans came into the stock market for the first time. Many of them were individual investors or they came in through their 401k's. We got to the point that by the end of the 1990's about half of American families were invested in the stock market and then they got clobbered, they got scared. Number one because of the meltdown, the great bubble popped technology and related industries. And number two, because of the corporate fraud scandals. And a lot of small investors got hurt. We saw a huge increase in the late 1990's, 7 trillion dollars in the stock market. Well, that 7 trillion dollars evaporated. And many small investors saw their savings disappear. They are not going to come back in until they know that not only can they believe what they see and read in corporate reports and there is not insider trading and self-dealing and CEO's are not feathering their nests. But also they have to have confidence that those corporations are really going to do better, and better, and better.

The savings of so many baby boomers was caught up in the stock market. Baby boomers savings are not there. This is why Social Security and Medicare becomes an even greater problem for us. It would be a problem fiscally even if we were not having a huge tax cut that threatened, jeopardized Social Security and Medicare. But it's a bigger problem now because so many baby boomers have to rely almost exclusively on Social Security and Medicare because their savings are gone.

Mr. Kemp

Can I make a comment? I agree with you about Martha Stewart. I think it's outrageous what's happening to her as a signal. And letting the folks from Enron, apparently, at least up until this time…

Senator Feinstein

Turn themselves in.

Jack Kemp

…egregious, egregious violations of their fiduciary and in my opinion their legal responsibilities. Having said that, I don't disagree with what Secretary Reich has said, actually more than 50% of the American people owned equity in corporations through 401k's, Roth IRA's, individual retirement accounts, pensions, I think it was closer to 60%. I have always believed that if you own your own home and you've got a little portfolio you create a more democratic capitalistic system. So we all agree that making capitalism more democratic is absolutely essential to creating a shareholder or stakeholder society. That's why I think President Bush is right and some Republicans and frankly Senator Moynihan wanted portions of the payroll tax to go into an individual retirement account. Putting aside that debate for just a moment, it seems to me that by bringing down the tax rate on investing in America is going to be good, now hold on a minute, this is going to get me in trouble but I'm going to say it anyway, the stock market. I think we need a rising stock market. I would make a case, that we've lost 7 trillion dollars in net worth to the U.S. economy over the last three or four years, the revenue, the tax revenue, from that would be close to, I don't know, 1.5 to 2 trillion dollars. There's your deficit. There's your deficit in Iowa, or California, or whatever state from which you might come. So we're right today and I applauded Tom, or applauded this committee for taking on the issue of how do we get America growing again and we may differ about the Pluribus but at least we have the Unum. We have the unity of purpose to get America moving again and I made a case, or tried to, that by bringing down the tax rate across the board accelerating the tax cuts and lowering the tax on capital gains and dividend income, we're lowering the cost of capital, we're lowering the cost of hiring someone and ergo that should be in the best interest of Democrats and Republicans not unlike what Kennedy did in the early 1960's.

Senator Dorgan

This panel has a lot to say obviously and it's been a fascinating discussion. I want to try to let the panel go by 11:30 if it's possible. Congressman Spratt.

Congressman Spratt

Thank you Mr. Chairman. I know now what the headline will be for this story tomorrow; it'll be Jack Kemp denounces administration for treatment of Martha Stewart. That's one of our problems, I'm not being entirely facetious it's that the public debate gets diverted to issues like that which are marginal really to what concerns us right now and we've had a hard time talking about the deficit, the savings rate, and the real effects of economic policy. You've added, both of you, quite a bit to the debate with your lively exchanges and your different points of view and we appreciate that very much.

Let me ask you or point out, particularly to Mr. Kemp, that according to, I don't have a large chart to this affect, but according to our calculation the Reagan-Bush rate of revenue growth from 1980 – 1988 was 2.38% real revenue growth from 1980 – 1988. From 1982 – 1992 the first President Bush's administration the real growth in revenues was 0.91%. During the Clinton years when we raised rates particularly on the top bracket a fortuitous increase because it happened to coincide with a big boom in the economy where most of the benefits were enjoyed by the upper bracket tax payers and we used those revenues to pay down the deficit; every year the bottom line of the deficit got better. Every year for ten straight years the economy grew, which was a post-war record. Revenue growth was 5.93%, doesn't that tell us something about what we're trying to say here that as we saved more, because building down the deficit is a way of stopping dis-saving and building up saving and adding to the pool of capital. We brought down the cost of capital, we increased the economic rate of growth, we had huge job growth, and we had huge economic growth. Doesn't that tell you something about deficit reduction and the potential benefits to our economy?

Mr. Reich

Congressman, you'll remember in 1993 in that budget debate, Republicans predicted that if we go ahead with that budget and that small tax increase, we're going to bring the economy to its knees. I'm paraphrasing, but that's almost an exact quote. And what happened? Just the opposite, we got our fiscal house in order, we continued investing in education, job training, infrastructure, and the economy had the longest peacetime expansion in history. And 22 million net new jobs.

Mr. Kemp

Let me pause for just a moment and put on my bipartisan hat and say that I applaud, I applaud publicly and privately that which happened in the 1990's. I disagree with the tax increase; I don't think it had anything to do with fiscal responsibility. I think that what brought fiscal responsibility was the huge increase in non-inflationary economic growth that was helped by a President, who was as free trade of a President as we have had in a very long time. He signed NAFTA, which cuts tariffs and tariffs are taxes. He passed welfare reform or he signed welfare reform and he allowed the capital gains tax to come down from twenty-eight to twenty. All very good pro-growth policies. And we had a chairman of The Fed who allowed the economy to grow up until the point of 1999 when he said it's irrational, you are to exuberant in America, I'm going to slow this economy down. I haven't talked about Chairman Greenspan of whom I have high regard and enormous affection and respect, but in 1999 with NASDAQ approaching 6,000 and the DOW going up and unemployment at an all-time low, which is good for America, that's why in my opinion he got re-elected in 1996, over my objections. Clearly it was the growth of the economy that brought the budget into balance and brought these enormous revenues to California, to Iowa, and to the country. So again, we've got to have growth, you've got to have a bigger pie and I don't think you can get it, Diane Feinstein asked the question what should we do, I think tax rate reduction across the board is important. I think deregulation of the telecom industry is absolutely essential. I think The Fed has eased recently and I think that's good. I think tariffs are too high on steel and on softwood lumber from Canada. I think it's very disappointing to me as a Republican, some of the free trade policies of the 1990's were followed with some of the protectionist policies of the twenty first century. My hope is that the Bush administration will reverse those policies and get those tariffs and duties down across the board. I think we can grow our way out of this fiscal mess, but I don't think you can do it by raising taxes. So if you think you're under taxed, Robert Reich is your man.

Mr. Reich

Wait a minute. What we're talking about here is whether fiscal responsibility combined with a public investment in education, job training, and infrastructure is a better policy and a better set of policies than the kind of supply side economics that we see coming out of this administration and we saw in the 1980's and early 1990's.

Mr. Kemp

Would you repeal the tax cut?

Mr. Reich

If it were me, I would repeal the portion of the tax cut going to the top 5% and I would use it instead, not only to make sure we had enough money in the bank for Social

Security and Medicare, but also to make investments that are critically important in our human capital. We're not doing it and I think we're going to pay the price for it.

<u>Mr. Kemp</u>

The top tax rate is 42% if you count the Medicare tax, payroll tax, and the income tax rates, so if you would raise the, you'd keep the top rate at 42.5% and you live in California, I forget what the top rate is in California. Is it nine or eleven?

<u>Senator Feinstein</u>

Last time I looked it was eleven, but that was a while ago.

<u>Mr. Kemp</u>

At the margin 51%, Senator it's too high, it's too high. I don't know what it should be, but again Robert is suggesting that the tax cut only goes to the so-called wealthy. Well, the so-called wealthy pay 39%. The top 1% of tax payers pay 39% of all the tax revenues, so if you're going to cut rates across the board as President Bush wants to do, it seems to me axiomatic that you're going to get ultimately more revenue if they will take their surplus income and invest it in job producing enterprises or expanding their enterprise.

<u>Mr. Reich</u>

But Jack Kemp, with all respect, you're evading the Senator's question and that question was, isn't it true that in the 1990's the combination of fiscal responsibility and investment in our people generated the longest period of peacetime prosperity we've had. And isn't that absolutely counter to the supply side nostrums coming out of this administration and the 1980's.

<u>Mr. Kemp</u>

I've never been accused of evading and I'll say it again more directly. President Clinton cut taxes in the 1990's and we had an accommodated monetary policy and a very pro growth trade policy and that led to the country's having a very strong non-inflationary economic growth, which gives us revenue to do the things that you want to do.

<u>Mr. Reich</u>

In other words, you're in favor of the Clinton economic policies and not the Bush administration economic policies. May the record show.

<u>Mr. Kemp</u>

That's a cute joke, but I think that even you understand what I'm saying Robert.

<u>Senator Dorgan</u>

It may be that we don't need to ask questions. This panel will operate quite satisfactorily without questions. Do you have one additional question Congressman Spratt?

<u>Congressman Spratt</u>

I have more than one, but I'll hold it to one. Wouldn't you agree, Mr. Kemp, that at some point your advocacy of additional tax cuts reaches a limit?

<u>Mr. Kemp</u>

Absolutely.

<u>Congressman Spratt</u>

The tax bill we have, the tax bills we have passed, two in particular, have sunsets all through them to diminish the apparent size of the tax reduction. If you include, if you assume that those sunsets will be repealed when the day of judgment finally comes and if you also look with political reality at the alternative minimum tax as the number of tax filers affected by it goes from 2.5 million to 30 million per treasury estimates, you have to admit that there's at least another 1.8 trillion dollars of tax reduction basically entailed, which is a logical sequel to what we've already done, if you add that to the impact of tax cuts already passed, you're up to nearly 4 trillion dollars in deficits. Well I can show you the numbers and we can argue about them but it's pretty close to that. At some point as you accumulate this enormous amount of debt the Republican budget resolution showed gross statutory debt growing from a little over 6 trillion dollars to 12 trillion dollars in ten years; their numbers. As you increase debt at this rate, you see a corresponding increase in debt service. We've enjoyed a dividend for the good fiscal behavior in the 1990's when we saw the debt service paid by the United States, net debt service, go down from 250, 252 billion dollars to about 170 billion dollars. That 50 billion bucks has been a big boon for things that otherwise couldn't have been done. Don't you reach the point where the American people, having to pay a debt tax of 300 billion dollars a year, and that's a logical outcome of these tax cuts, begin to say, I'm paying all this money and getting nothing in return for it. It breeds cynicism of our government and in truth we have to collect taxes and therefore create disincentives for labor and investment in order to service the debt that we've accumulated so improvidently. Isn't that a problem?

Mr. Kemp

Well again, if you accept your premise it is a problem, but what you fail to acknowledge is that we have an 11 trillion dollar GDP and over ten years, if my calculations are right, that's more than 111 trillion dollars, so the so-called 300 billion dollar deficit over ten years, 3 trillion as you point out, measured against the size of our economy is miniscule compared to the many things that we've experienced in the past.

Congressman Spratt

The deficits and the debt build up that we're talking about are premised on a growing economy. CBO and OMB both assume that the economy will be growing better than 3% real growth over the next ten years and we still have 4 trillion dollars in debt accumulation; debt held by the public.

Mr. Kemp

Well again, if the economy grows at 3% or 4% per annum over the next ten years and 11.1 trillion economy, that's more than enough to service debt. I'm suggesting that you have to not only show us the denominator, you've got to show us the numerator. And I'm trying to point out, as I did in my little metaphor of Jim Kelly and Jack Kemp, I made $50,000 a year, Kelly played quarterback for the Bills and made $5 million a year, we both had the same debt. In abstract terms or in absolute terms, but you have to measure the Kemp family debt against his income, which was more than ten times mine; and you're not doing that. And I'll say one more thing as a postscript.

Congressman Spratt

Don't forget now, defense is going up, homeland security is going up, Medicare is going up, Medicaid is going up, you say we can service the debt, but there are other obligations in the federal budget as well.

Mr. Kemp

Absolutely. I mean only when it's….

Congressman Spratt

Baby boomers are retiring, 77 million of them.

Mr. Kemp

Congressman, the only way we can service those needs from Medicare, to Social Security, to education, to roads and highways is to make the pie bigger, make the economy grow, and getting the economy bigger and getting more revenue to do those things that you and I both would do, although we may have some disagreement on the edges, I too want to save Social Security. I don't think you can save it unless we get the growth rates of this economy up to 4.5% per annum without inflation. I don't think you can do it with a tax burden carried by the American people.

Congressman Spratt

Just one small question. Don't you believe that net national saving is deficient and needs to be increased and that by reducing that deficit we do just that?

Mr. Kemp

Well if you're saying that deficits and debt crowd out savings, so do taxes. Taxes crowd out investment.

Senator Dorgan

Mr. Reich, why don't you, you're aching for a very brief response and then I'll call on Congressman Scott.

Mr. Reich

Briefly, the problem of the federal debt is clearly a growing problem. And undoubtedly, as that debt increases, people have to pay more and more to service that debt, and the cynicism to which you refer to Congressman is absolutely deeply held in the United States. Now what Jack Kemp keeps saying to you is don't worry about that, don't worry about the debt because these tax reductions are going to grow the economy. And it's going to grow the economy so fast that the debt shrinks in proportion to the total economy. Now that was the argument we heard in the 1980's. We ended up the 1980's and the early 1990's with, as you recall, this 300 billion dollar debt, as deficit, as far as the eye could see and an economy that basically ground to a halt. I want to grow the economy as badly as Jack Kemp wants to grow the economy, but there are very different ways of growing the economy. You can't grow the economy by simply expecting that rich people are going to take their money and invest in plants and equipment that are here in the United States. Savings are going to go all over the world. The way you grow the economy, is you combine fiscal responsibility with investments in people--in education, and job training, and so on and so forth, and their health care. If you don't do that you're not going to grow the economy.

Senator Dorgan

Congressman Scott.

Congressman Scott

Thank you Mr. Chairman. And Mr. Reich, refresh my memory, President Clinton signed that tax cut but that was after we had established fiscal responsibility and gotten the deficit down from 290 billion down to less than 10 billion when he signed that tax cut. Is that right?

Mr. Reich

That's my memory too.

Congressman Scott

And that the only tax cut prior to that that was cut was an increase in earned income tax credit.

Mr. Reich

That's right.

Congressman Scott

It seems to me, and Mr. Reich do you disagree, that if you want to help investors the best thing you can do isn't a little marginal tax reduction but improve the economy so that the stock market will go up and everyone will make, all the investors will make a lot more money if the economy is better.

Mr. Reich

Absolutely. And Congressman, the cost of capital right now, given the low rate of interest is historically low. Now Mr. Kemp keeps talking about lowering the cost of capital. If you're a businessman, you can go out and get a loan right now that is cheaper than you could ever have got it. The problem is not the cost of capital; the problem in the immediate future is inadequate demand. No businessman is going to expand unless he or she knows that there is going to be an adequate demand for the goods and services that that factory or that business produces. Over the long-term the problem is not cost of capital either, because that cost of capital is established in global, increasingly in global capital markets.

Congressman Scott

But in terms of cost of capital what are credit card rates, for short term promotional rates down to now?

Mr. Reich

Credit card rates, I don't have the figure in front of me, but credit card rates are relatively high.

Congressman Scott

Have you seen 0% promotional rates?

Mr. Reich

I've seen promotional rates for automobiles and related durables at 0%.

Congressman Scott

I've seen credit card rates at zero. Short term. Of course if you don't pay it off real quick, you're going to end up paying a lot more. This is a chart I think describing the deficit and how bad it got the eight years during the Clinton administration fiscal responsibility and where we are now. My question to Mr. Kemp is exactly how bad does it have to get before we have to change directions particularly in light of the fact that you keep using the entire economy as the denominator? It seems to me that the budget, the federal budget would be a more appropriate denominator and we are approaching if you take out pensions and defense, the interest on the national debt is getting to the point where you would have to eliminate the entire budget to get the interest on the national debt in 2013 on the President's budget is close to 500 billion dollars. The defense budget is 400 billion. Everything other than defense and pensions is about 800 billion, so when you say lets just cut back a little, I mean you'd have to eliminate just about everything. It seems to me that that is a more appropriate denominator and my question is that since the debt is going up, the deficit is going up adding to the debt, we are at historic low interest rates now, how much more debt can we accumulate before somebody notices that something has gone wrong?

Mr. Kemp

Well what's gone wrong is the economy is not performing up to the expectations of either the people of the country or you and me. But with all due respect Congressman, if you could only cut tax rates when your budget is in perfect balance, John F. Kennedy could not have cut the 90% rate to 70%. You know what the tax rate was under Nixon and Ford and Carter? Seventy. The capital gain tax was fifty. If Ronald Reagan had waited to cut tax rates until we had balanced the budget, we never would have cut tax rates. Well you can say now well we shouldn't have, but I want to remind you that when Reagan took office in 1981, the deficit was 2.7% of GDP. When he left office in 1989 it was 2.9% of GDP. I think revenues had gone up from 400 billion to 1 trillion dollars. If we want more revenue we have to reduce the fiscal drag on the economy, some of which Robert Reich has alluded to, I'm for more spending on certain levels, and I am also supporting President Bush's tax rate reductions because I believe that it will help get the economy growing again and there is the essential ingredient. So if you just show the red ink without showing us the numerator, I know your staff did a good job of putting all that red ink up there under Bush, but it doesn't tell us a thing. It doesn't tell us one thing. It doesn't tell all these young people that the economy is 11.3 trillion dollars in 2004. So if you don't say that, you're in my opinion, it is not giving us all of the facts that we need to make an informed judgment.

Congressman Scott

If you follow that to the natural conclusion you can eliminate all taxes.

Mr. Kemp

No, there's no revenue at zero taxes. I'm for revenue.

Congressman Scott

Yeah, but the entire federal budget is only a small portion of the entire GNP.

Mr. Kemp

No, the purpose of leadership is to find the level of taxation at which people are willing to maximize their output and still pay tax and I think frankly, the tax burden on the American economy…

Congressman Scott

Why do you need to pay taxes at all if you're measuring it against the GDP?

Mr. Kemp

I don't I want revenue. The only way to get revenue is to have a tax code that encourages investment, savings, and work. So in my opinion the tax rate should be no higher in peacetime than 25%. I would take it lower, but that's not for Kemp or Reich to say. Now he would take it to fifty. I think fifty is too high in peacetime.

Congressman Scott

My question was how bad does it have to get before we notice something was wrong, I'm not sure I got much of an answer but thank you though.

Mr. Kemp

Well Congressman, I respect you and I hope you respect the testimony that I've given today. I suggested that when we came out of World War II, Harry Truman was faced with red ink that would've dwarfed that policy. You're not showing the American people the true extent of our problems if you don't show the size of the economy. We had 140% of GDP in debt and the deficit was 45% of GDP, we cut tax rates thanks to Harry Truman and John F. Kennedy. So to be fair to both parties, I'm suggesting that your party is wondering into a very serious political problem if you think that by raising taxes you're going to reduce that red ink. We tried it for a long time now you can have the issue.

Senator Dorgan

Mr. Reich.

Mr. Reich

The difference between the economy of the early Reagan years, to which Jack Kemp keeps on referring, and the economy right now is that we are eight years away from the first of the baby boomers starting to collect Social Security and Medicare. We've got a huge demographic pig moving through the python if you will. And how we deal with that and at the same time spend 400 billion dollars a year on national defense and at the same time deal with the health needs of our people and the education needs and given that right now that we know the states are cutting back on critical social services and education we're not doing that. How we accomplish all of this and at the same time provide a huge tax break to people who are very wealthy at a time in our nation's history where the gap between the people at the top and the people in the middle has not been as wide at least since 1920, this makes no sense at all. This doesn't, there's no explanation. All I am hearing, with due respect, from my friend Jack Kemp, is cut taxes you get a bigger pie. Now that is the nostrum of supply side economics. We tried it in the 1980's.

Mr. Kemp

It worked.

Mr. Reich

We ended up with nothing trickling down to the bottom and we ended up with in 1991 and 1990 – 1991, with a huge recession and we ended up with deficits as far as the eye could see. When we in the Clinton administration came to town in 1993 it was like coming to town with a giant pooper-scooper. We had to clean up the mess. Does Jack Kemp not remember that mess?

Mr. Kemp

I do. I do.

Senator Dorgan

On that descriptive note, we will turn to Senator Harkin. Senator Harkin, would you inquire?

Mr. Kemp

Tough to argue with pooper-scoopers.

Senator Harkin

I've really been enjoying this. I was watching this on television before I came over there so I heard a lot of the stuff before, but I first of all, again for my good friend Bob Reich to be here, I mean this is a sort of a home turf, but I just want to pay my respects to Kemp one more time for wading into the maelstrom here. It's typical Jack Kemp and I say that with a lot of respect and friendship going back for many, many years. You've never been one to not engage in this type of a debate even though it may not be in front of the friendliest audience and so I've always appreciated that about you. I don't always agree with you, but well what the heck, I do find your willingness to debate these issues openly very refreshing, I wish we had more of this going on in our society.

Mr. Kemp

Thank you.

Senator Harkin

The JFK speech: a different world, a different time. We talked about all of those high rates: Those all came in World War II to pay for the war. They were all too high obviously, but we had to pay for the war, and so there is always a lag time in government and cutting back on those kinds of things. Although I commend you and I'm sure both of you have read Kevin Phillips book, "Wealth and Democracy", if you haven't I commend it greatly, it just came out last year. He pointed out some very interesting things in there, that over the last forty years the percent of total federal revenues coming from median income families has gone up tremendously. I don't have the figures in front of me it went up tremendously. The percent of total federal revenues of the top 1% has come down dramatically. Then in the next chapter he points out that the percent of federal revenues, total federal revenues coming from corporate taxes over the last forty years has dropped tremendously, but the percent of federal revenues from payroll taxes has gone up, if I remember that, that was three times. Well, the picture you get from that is that more and more the middle class is paying the burden and those at the top aren't. He also points out there's been a tremendous divergence in the last thirty years between the top and the bottom. The average CEO recompense is now 200 times over the average worker, thirty some years ago it was maybe forty times. So you've had this tremendous widening of the gap. He has one premise in his book, not a premise, but I think that he shows later on in the book that one of the greatest periods of growth in the United States in wealth, in wealth generation, was during the time when we had the least gap between the top and the bottom. And that is not happening now, it's going just in the opposite direction of that. And so even with those high tax rates we had in the 1950's, we had a pretty good growth in this country in the 1950's. We had good growth in all sectors of our country in the 1950's. I think what maybe Kennedy and those people saw at the time was that it reached a point where it was going to stagnate and something had to be done about that. Now I just say that as a premise to two challenges I have for both of you.

For Bob Reich, I keep hearing from my friends sort of on the liberal side that say that we've got to increase demand. Therefore we've got to give more money to working families, low income, because they spend the money. They go out and they spend it. Now again, forty years ago I think that would have rung more true than it does now, or thirty years ago. But now if you give an extra dollar of consumption to a low income person who goes out and spends it why they might buy a shirt, the shirt is not made here, it's made in another country. Now some of that money spends around here because you've got a salesperson and stores and that kind of stuff, but the bulk of it goes overseas. You might buy a TV set, forty years ago it was made here, now it's made overseas. They might buy a radio; they might buy a stereo; they might buy a lot of things. They're all imported into this country. So a good portion from that extra dollar in demand is not staying in this country. And so why do we keep putting this reliance upon stimulating growth in our own country, in our own economy, by trying to stimulate demand for consumer goods. It doesn't seem to add up.

Mr. Reich

Well Senator, two responses. One, I recommended that it is not just that we stimulate growth and stimulate demand through giving average working people more money, but also that we help the states in regard to their obligations right now in providing social services, education, and everything else that is very important to average working people. That money, by the way those service sector jobs, both in the public sector and in the private sector, they are here, unambiguously here.

Now secondly, the dollar is dropping. It's dropping because a lot of investors around the world are worried, frankly, about the American economy. The good news is that as the dollar drops, it's easier for us to export. Everything we export from the United States is cheaper. That means more jobs here. You are absolutely right in regards to with a dollar spent on textiles, or a dollar spent on a television set, some of that dollar does go abroad, but a lot of it even with the dollar relatively high stays here in terms of sales, and inventories, and marketing, and legal services, and all sorts of other services that are unambiguously here in the United States. That does help stimulate demand. But what is not going to stimulate demand, and let me underscore this with three underscored lines, is if you give a very wealthy person a tax break and that wealthy person doesn't spend it, because a wealthy person is spending basically as much as that wealthy person wants to spend, and puts it maybe into the stock market or into a bond fund, that money is quickly going around the world to wherever it can get the highest return. Not even stopping here for a breath. It moves at the speed of an electronic impulse anywhere around the world that that money can get the highest return.

Mr. Kemp

Could I…Tom, thanks for your comment and I said; you weren't here when I said it, how much respect I have for your party. We have two great parties and I have enormous respect…

Senator Harkin

Not withstanding the fact that you always try to beat us, I mean what the heck.

Mr. Kemp

Same here, but civil rights, human rights, community; my party is kind of individualism, entrepreneurship, and we need both great parties to work and the balance, the equilibrium, is established in the democratic process. So I call myself all the time a democratic-Republican, small "d". Now having said that, the problem I have with your definition of middle class, today you could be middle class and be around $100,000. When I grew up in L.A. in the 1940's and 1950's, middle class was my poppa and mama who probably brought in $15,000 a year. Now 75% of all the revenue from this tax cut, or tax rate reduction as I would call it, 75% of all the revenues will come in from people and families who earn more than $100,000. That's not a lot of money today. Now having said that, I'm on the board for Toyota, there diversity board for North America. If you buy a Toyota today you don't know if it was made in Japan, or Ohio, or Kentucky, the new Tundra is going to be built in San Antonio with 75% of the parts being made in the United States. That's the thing about a global economy. That T.V. set Tom, many of the parts may be made in Buffalo, New York, or in Iowa, or somewhere; all things are fungible. And frankly I agree with Robert Reich. We have an economy that's global; capital goes where it's welcome, where it's secure, that's why I want to lower the cost of investing in the United States. Now Robert Reich, bless his heart, makes fun of a tax rate reduction that might go to an investor putting more money into stock. Where do small businesses in Iowa get the revenue, or I should say get the capital? We have the most efficient capital markets on the face of the earth. To make fun of an investor putting his or her money into equities, I think is to make fun, or make light of our capitalistic system, and frankly it isn't working to the benefit of all people and making it work, well, democratizing it is what I would like to see happen from both political parties.

Mr. Reich

I never would make fun of anybody investing in the stock market, but here I do think, Senator, there is a legitimate question. There are some people around, many of whom call themselves Republicans who want to privatize Social Security. And anybody who looks at the stock market and says that now is the time to privatize and put a lot of savings in the stock market is not really facing reality. The stock market is a casino.

Mr. Kemp

Pat Moynihan called for privatizing three percentage points of the payroll tax, is he somehow unpatriotic? Yet, and it's off the subject to talk about privatization, because I don't think anybody is suggesting that right now.

Senator Harkin

Can I reclaim a little bit of my time here anyway? This is a great discussion; I wish we could go on for a long time on this. But don't get me started Jack, on small businesses in Iowa. We are a, in our capitalist system we are at a disadvantage. They have to pay a higher rate for their investment capital than the big businesses in other parts of the country. It's been true of my farmers for years. They always pay a higher rate. Don't get me started on that. I mean the small business pays a higher rate for their capital than does a big business. Therefore, Wal-Mart and them, they have it over my Main Street businesses. Therefore we have to skew and to provide capital to small businesses and to farm families at a lower rate than what they've got. But I know my time is running out.

The problem I have with this demand side is simply that--what I said and I repeat it for emphasis' sake--that a lot of this money goes outside because of the world economy. I did an experiment over the last few years. I've been on this kick for a long time, as you know Bob, about the federal government investing in infrastructure. And so I tried to get the Clinton administration, finally we did at the end but then it's been stopped, to invest in building schools Jack around the country. I did an experiment. As of right now, I've got over 87 million dollars that I've earmarked for the state of Iowa just to rebuild and modernize school buildings. That's all. Build new classrooms. Build new schools. Build them up. Make them nice places. Eighty-seven million dollars that has multiplied to over a billion dollars of investment. Now, what happens?

When you invest in something like that, think about this, all the bricks and mortar are made in this country, all of the workers obviously are here because they've got to be to work on it, all of the electric lights, the wiring, the piping, the tubing, all that made in America. Everything is made here plus the workers work here and they spend the money in the local economy. Then what do you get out of it? You get better schools and better buildings that last a long time in our country. So you talk about capital Jack, and when I was hearing you in my office I went to my big Webster's Dictionary, and I said what the heck is the definition of capital? We throw that word around a lot now. It's "the accumulated assets, resources, sources of strength, or advantages utilized to aid in accomplishing an end or furthering a pursuit." So it could be financial capital; it could be scientific capital; it could be educational capital; it could be all kinds of assets that are out there in furthering a pursuit.

My problem with some of your approaches, anyway, is that by continuing to reduce these tax rates and by giving more money to the wealthy in order to invest, they are not going to invest in roads and bridges. They are not going to invest in school buildings. They're not going to invest in medical research. They're not going to invest in scientific research. They're not going to invest in what I call the veins and arteries of our capitalist system, which only us as a society can do and which we can only do through government. So in a way I kind of disagree with both of you. I think we ought to be focusing, if we really want to build up our economy in building up the wealth.

As Kevin Phillips said in his book, he citied this sixteenth century Spanish philosopher who pointed out that money is not wealth. Money is not wealth; it's what gives you the productive capacity to grow that's wealth. And we're not doing that in this country. I say to you Jack, as you give more money to people at the top, yeah, they may invest it in God knows what overseas, here they may buy bigger yachts or whatever fancy, but if you put it into the infrastructure of this country then, you produce wealth in this country. That's my difference a little bit with both of you.

Senator Dorgan

Let me ask for responses from both of our witnesses and then we have an additional panel of three witnesses. Mr. Harkin, thank you. Mr. Kemp first and then Mr. Reich.

Mr. Kemp

Well I've enjoyed it, believe it or not, and I have immense respect for the questions and both sides of this debate. I want to make it clear--unambiguously clear--I do not want to give a tax cut to the rich. I want to set the rate of taxation in this country at which people are willing to maximize their output and still pay taxes into the federal and state government. My belief is over time, there's empirical, objective, historical evidence, that tax rates that are too high discourages investment. I'm making a case that I believe, and I appreciate the invitation from my friend Chairman Dorgan, to defend the Bush tax cut of lowering the cost of investment in the United States making it more attractive to invest in the United States to create more jobs, create more growth, to get more revenue not less. Congressman Spratt asked me, or maybe it was Representative Scott, would I go to zero?

No, I don't want to go to zero. At zero there's no revenue. I think you'll get more revenue for government spending. This is what puts me at odds with the right wing of my party. I do not want the federal government starved for revenue. I don't want to hurt Social Security by raising the age limit, or taking away benefits. I want to make the economy grow so fast and so strongly that we have more revenue for the social goals that you expressed and I think Congressman Scott expressed and I think all of us would express, and I think we can do it by getting the rates set at a more propitious level. And I would make a case that 40% to 50% is not a good level of taxation to get the maximum amount of revenue. Don't go to zero, but I think basically, in peacetime the tax rate in America should be no higher than 20%. And if tomorrow you had a 20% income tax rate and a zero tax on the poor up to about 190% of poverty, and no capital gain tax on any man or woman that invests in north Philly, or in the inner city of Des Moines, or my home town L.A., south central L.A., I think you would have a growing economy macro and you'd be able to drive capital into the inner city. So Tom, I totally agree with you. The word capitalism, capital comes from the Latin caput, the head. Intellectual capital, education capital, what a mother teaches her children is capital, what a poppa passes on to his family is capital, and what we want in this country is a more democratized system of capitalism.

Senator Harkin

So you don't agree with Grover Norquist?

Mr. Kemp

I don't defend Grover Norquist. I don't know what he said.

Senator Harkin

Oh, he said that he didn't want to kill government, he just wanted to reduce the size of government so small that he could drag it into the bathroom and drown it in the bathtub.

Mr. Kemp

I do not agree with that.

Senator Dorgan

Mr. Reich.

Mr. Kemp

Publicly, privately, politically I do not agree with that.

Mr. Reich

Well first of all let me thank Chairman, and the committee, and also my good friend Jack Kemp. I think it is important that Republicans and Democrats have, and people from all views, have a genuine debate about something that is touching every American right now. And we don't have enough debate, enough debate in which people are listening to each other. And for the record, I'm going to say that to the Republican Policy Committee, I want to make myself available and I'll debate anybody. But let me respond

Senator to your specific question and that was isn't it important now to invest in capital that is uniquely American. Our infrastructure. Our energy, security, why should we be so dependent on Middle Eastern oil when we could develop solar, and wind, and other forms of energy. Why are we not investing in our people enough? Why are state universities now starving for money?

Our states are cutting back on education. These are the critical investments and if there's one fundamental difference between Jack Kemp, Jack's and my position on long term growth, I think we agree that on short term stimulus that the Bush tax cut is not a short term stimulus, but in terms of long term growth the big difference is that I think the way to do it is to invest in infrastructure and people. Those are the unique assets that are here in the United States. And if we do that and increase our productivity, global capital will come. Global capital wants a high rate of return. The only alternative for us is to become basically a low wage, low cost place, where we provide global capital a high return because we're so cheap. But that doesn't yield and generate high-wage jobs. The only way we're going to generate a prosperity that is widely enjoyed in this country is if we invest in the unique capacities of Americans. So you're 100% right Senator and I hope that when we have a Democratic President back in The White House and a Democratic Majority in Congress, we can follow that direction. Thank you.

Senator Dorgan

Mr. Reich and Mr. Kemp let me make one final point. So much of the coverage in America these days, coverage on the great debates of Congress and related items is about who's ahead, who's behind, what are the votes rather than the substance. And I think this morning's discussion was a wonderful discussion about the substance of two different philosophies. As I said when we started, we all want to get to exactly the same place. There's no disagreement about goals, disagreement is however about methods. And I think your discussion, aired this morning on C-SPAN, I extraordinarily beneficial to the American people to get a sense of how two different sides, two different people, two different philosophies view this problem that we face, and we do face problems, and how we aspire to achieve the same goals from different centers. So let me thank both of you for coming we have three additional witnesses today. Thank you for giving us your morning. Mr. Kemp and Mr. Reich, thank you very much.

Second Panel
Speakers Mr. Lawrence Mishel, Mr. Mark Zandi, and Mr. William Gale.

Mr. Mishel

The problem is that we now have a new policy that has been set to address this problem, that is the Bush tax cuts and I think it's very important that now that this has passed that we be clear as to following the course of the economy and measuring whether in fact this is successful or not and we should establish the framework for measuring that success right now before anyone makes any excuses one way or another from one side of the aisle or the other about what's expected to happen and what is a measure of success. When it comes to the labor market, we have 6.1% unemployment; that's too high. What hasn't been commented on so much is that a high unemployment effects people who are employed because their wage growth is less and that the accumulative effect of the high unemployment over the last two or three years has now led wage growth to fall, it's now slower, and it became so slow that in fact wages are growing more slowly than inflation. That has happened for four quarters in a row recently and that's the first time since 1990, and that's true for a low wageworker, it's true for a middle wageworker, and it's true for a high wageworker.

So unemployment is not something that impacts just the unemployed it affects the employed. Also true is that we have not had this big a contraction of employment in any recession or downturn since the 1930's. We've lost 2.7% of the private sector job base this far into the downturn. That's larger than at any time since the early 1930's. So it seems to me that there's a big problem with jobs out there, we have a problem with wages, therefore we have a problem with the incomes that typical families are relying on; they've been declining since the year 2000 in my view, they declined in 2001, they declined in 2002, I think they are declining right now. So we're all agreed we need jobs. Which brings us to the Bush tax plan. This plan is flawed in many ways and I'll defer to Bill Gayle who's going to describe the various ways in which the tax plan is not very well designed to create a short term stimulus.

What I want to do is to focus on how will we know whether in fact it has failed or not. And to know this is not just to know that the administrations claim that it's going to create 1.4 million jobs. President Bush in his tour of the country in all the states where he wanted to have a Senator vote for his plan touted that it was about job creation and that they were going to create 1.4 million jobs. What's important to know is that it's not just the 1.4 million jobs that has to be created to be judged a success, because of course every economic forecaster would have said that we were going to create some jobs anyway. It wasn't as if the economy was going to have no jobs into the foreseeable future without the tax cut. If you look at the Council of Economic Advisors' own study from February, which is where you get the 1.4 million number, you will see that they projected that baseline growth, the economy even without the tax cut, would generate 2.2% new jobs a year. And over the time period from this summer until the year 2004, that amounts to 4.1 million jobs. Let me go over the charts of this. You can see in this first chart two lines. This is a chart much like the one in the President's Council of Economic Advisors' report in February and as I think everybody knows, the Council of Economic Advisors is essentially the President's personal economic staff, The White House staff.

So this is not some outside group doing this study, this is the President's own advisors. And you can see that the orange line is the line that shows the growth of jobs with no change in policy and the white line, and you can see that by the end of 2004 they expected with no change in policy, in between July 2003 and November 2004, there would be 4.1 million jobs created. That's the baseline growth. That's the growth you would get if there had not been any change in tax policy. Now, where do you get the 1.4 million jobs is that the white line shows what would be the job growth if you had the economy as it were and you add the Bush tax plan. So together with the 4.1 million jobs that we would get having done nothing and the one point four that has basically been promised as a consequence of the tax cut, that means that the jobs we should expect between July 2003 and November 2004 is 5.5 million jobs. In order to be judged a success that's how many jobs have to be created between now and November 2004. So that boils down to, we expect according the Bush Economic Advisors study, the economy was going to be creating about 250,000 jobs a month anyway. With the tax plan you get another roughly 88,000 jobs and so we should be expecting starting in July 344,000 jobs created each month. Any amount of jobs less than 250,000 roughly starting in July, and August, and September means that the administration is not getting the amount of jobs they thought they would get anyway without a tax plan. If they create more than 250,000 jobs a month, those jobs are jobs that they can claim as a result of their tax plan. So we will be keeping track of that and I recommend that the citizens of the country keep track of how many jobs are created each month starting in July 2003 and everyone could keep score. The series is The Bureau of Labor Statistics non-farm payroll employment, which is available the first Friday of every month you can see the job level last year. Is this a fair metric?

Well this baseline growth the jobs that they're expecting anyway is very much in line with the job growth we had when we came out of the last jobless recovery in June 1992. It's actually, the expected jobs, 250,000 a month, that's less than the job growth we had in between 1993 and 2000 in the last recovery. So the expectation of the economy that we're going to create roughly 250,000 jobs, even without a tax cut, is very modest. That's their own assumption, and it's a reasonable one.

Now is it fair to hold the administration accountable for the tax package that just passed rather than the one that they originally proposed? My answer and I think it's there's as well is absolutely yes. The amount of fiscal expenditure, the amount that the deficit rises in fiscal 2003 and fiscal 2004 as a result of the original plan would have been about 155 billion. In the plan that was actually passed it's 210 billion. It's a third bigger. The actual amount of money being spent in the economy in the plan that was passed is a third bigger than what originally proposed. So holding them accountable for the actual amount of jobs that they thought originally they would generate seems to me very modest. And of course the administration has a lot of jobs to create just to be able to say that it left office with the same number of jobs that were in the economy when they took office just to get back to the private sector job base that they inherited from the Clinton administration they're going to have to create around 175,000 jobs a month.

So there are some markers. 175,000 jobs just to break even for the whole administration. 250,000 just to keep up with what the economy ought to be producing anyway and around 300,000 to say that there plan worked.

Senator Dorgan

Mr. Mishel thank you very much, Mr. Zandi why don't you proceed

Mr. Mark Zandi

Mr. Chairman and members of the Committee, my name is Mark Zandi. I am the Chief Economist and Co-founder of Economy.com.

Economy.com is an independent provider of economic, financial, country, and industry research designed to meet the diverse planning and information needs of businesses, governments, and professional investors worldwide.

Economy.com was founded in 1990. We are an employee-owned corporation, headquartered in West Chester, Pennsylvania, a suburb of Philadelphia. We also maintain an office in London.

The economy is struggling and nowhere is this clearest than in the job market. The economy has lost over two million jobs in the past two years and the job losses have been notably broad-based across industries and regions of the country.

The economy needs more help from monetary and fiscal policymakers, and the recently passed *Jobs and Growth Tax Relief Reconciliation Act* is a laudable effort, given substantial political limitations, to provide that help. The plan does nothing to directly support the job market, however, and although employment will be higher this year and next as a result of the legislation, these job gains will at best be very modest.

While expectations are strong that the economy will soon rebound and job growth soon thereafter, it clearly may not. Policymakers must therefore prepare now to provide even more economic stimulus, which should be specifically designed to help increasingly disenfranchised workers and induce businesses to resume hiring. Steps that should be considered include expanding the availability of extended unemployment insurance benefits, a payroll tax holiday, and specifically addressing the large and mounting burden businesses bear providing healthcare benefits to their employees. I will address each of these points in some detail.

The economy is eking out real GDP gains and the housing and mortgage market continue to boom, but there's not much else positive in the economy to point to. Most disconcerting is that the economy's problems are particularly prolonged and broad-based. Job rolls have been more or less declining for over two years. Even by this stage during the jobless recovery of the early 1990s the economy had begun to generate a substantial number of jobs. Not since the Great Depression has the economy lost jobs over such an extended period.

The job losses are particularly widespread. Industries as wide-ranging as manufacturing, commercial construction, travel, retailing, investment banking, and now state governments are reducing payrolls. The economy's difficulties are also widespread from coast-to-coast. Large economies ranging from Boston and New York in the Northeast, Atlanta and Dallas in the South, Chicago and Detroit in the Midwest, and the Bay Area of California and Denver in the West, are engulfed in full-blown recessions.
The recent passage of more tax cuts and aid to state governments will provide a modest but much needed near-term boost to the struggling economy.

The economic stimulus provided by the plan will add an estimated one-half a percentage point to annualized real GDP growth during the second half of this year and a similar amount in 2004. Through the potpourri of provisions in the plan it will quickly put cash into household pockets, increase tax incentives for business investment, and provide aid to hard-pressed state governments. Investors will also receive a break from lower dividend and capital gains tax rates, although this will provide little boost to the economy even if investors attach a high probability to the possibility that the tax breaks will be renewed when they are set to expire later in the decade.

The plan does nothing to directly lower the cost of labor to businesses, however. Indeed, the plan is expected to result in some 250,000 more jobs by the end of this year and 500,000 jobs by year's end 2004. While not unimportant, the positive job impacts are small (the economy has lost over half a million jobs since the beginning of this year alone), and the cost to the Treasury of generating these jobs is substantial. Not much of an employment bang for the buck. Moreover, even assuming the sunset provisions in the plan are adhered to, the larger budget deficits and higher long-term interest rates that result from the plan will lead to fewer, not more, jobs in the longer-run.

Most economists, myself included, are expecting the economy to soon rebound and to resume creating a meaningful number of jobs by this time next year. Improved confidence and lower energy prices in the wake of the Iraq war, a renewed vow by the Federal Reserve to be more aggressive in easing monetary policy, a lower value of the dollar, continued resilient productivity gains, and more tax cuts should soon reap economic benefits. Most economists, myself included, have been wrong, however, about the strength and staying power of the current recovery. It is not inconceivable that economists, again myself included, could once more be wrong.

Fiscal policymakers should thus be prepared to quickly come again to aid of the economy. This time, that stimulus should be explicitly designed to help the hardest-pressed part of the economy, namely the job market. What should policymakers be considering? First, to help those that most need it, and at the same time get a large bang for the economic buck, the availability of extended unemployment insurance benefits, beyond those provided by the recently renewed temporary extended unemployment insurance compensation program, should be expanded. No more than a handful of states, whose jobless rates are high and have risen significantly, are eligible for these benefits. The requirements for eligibility for this aid should be relaxed. The change in the unemployment rate is a particularly poor measure of job market stress. Given the very prolonged problems in the job market in many communities, many previous workers are stepping out of the job market altogether, and thus not even being counted as unemployed.

Second, policymakers should consider a payroll tax holiday for both employees and employers. This would benefit all workers, wealthy and poor, and all employers, large and small. It would directly lower the cost of labor, and thus reduce the incentive for businesses to shed more workers. And since it is a holiday, the length of which would be determined by the severity of the economy's problems, it will not impact the federal government's long-term fiscal health and thus long-term interest rates. Such a holiday would be particularly efficacious leading up to and during the key Christmas buying season.

Finally, and perhaps most importantly, it is time for federal policymakers to carefully consider becoming more proactive in addressing what threatens to be large increases in employer healthcare costs long into the future. Businesses are not only considering their current healthcare bill when making hiring decisions, but they are considering the discounted cost of providing future health care benefits to additional employees. These costs appear particularly daunting given that there appears to be little meaningful reaction by policymakers to date. Partial privatization of Medicare, in exchange for new prescription drug benefits, is not a meaningful first step. The federal government instead should take a cue from state governments working to rein in their Medicaid costs, and enhance and use its size and market power to negotiate better terms and prices for beneficiaries.

The economy and the job market in particular have struggled significantly since the beginning of the millennium. Policymakers have acted aggressively to jump-start both, but so far to little avail. Even more help from policymakers may be needed in the months ahead. That help should be designed to directly support the willingness and ability of businesses to increase their payrolls. Thank you.

Senator Dorgan (D-ND)

Mr. Zandi, thank you very much, and Mr. Gale, welcome back, why don't you proceed.

Mr. Gale

Thank you very much, Mr. Chairman, members of the Committee, it's an honor to testify at this hearing, and I thank you for inviting me. I have two simple points to make: the first is that the recent tax cut will do a poor job of stimulating the economy in the short run, the second is that it will do an even worse job providing long term jobs and growth. Let's start with the short term. Right now, the current impediment is that we are not using our existing capacity, our existing equipment. As a result, workers lose jobs, as a result of that, consumer demand falls, as a result of that workers lose more jobs, and so on. The key in the short run is to boost aggregate demand, which would encourage businesses to make more uses of their existing capacity, and to hire more workers, given their existing capacity.

The tax cut in the short term will boost aggregate demand and thereby generate higher short term levels of income or employment that would occur if no policy were enacted. But this is an extremely minor accomplishment. Almost any increase in income or cut in taxes would boost an economy; the question is whether the tax cut is the best way to achieve these goals and the answer is a resounding no. The same or bigger stimulus can be obtained in the short run, with a lower cost in the long run, with a more equitable distribution of benefits and less deterioration or more preservation of basic social needs. So the point here is even if you accept the administration's job figure, one could have gotten to that job figure with a less expensive, less regressive, tax cut.

There are two main reasons why the tax cut will fail to stimulate growth in the short run. The first is has been mentioned earlier, and that it is regressive. Putting money in the hands of the wealthy is going to create less new spending than if that money were put into the pockets of low-income households. The other reason which I think is equally important but I think has not been mentioned so far, is that the intent of Republican majority to make the bonus appreciation rules permanent, is causing a reduction in investment now. And the way that works is that in 2002 we passed a temporary depreciation balances that were set to expire in 2004; the intent of temporary investment credit is to get firms to invest now. In the recent tax bill we increased the amount of bonus appreciation and extended the time period in which it applied, and Republican leaders in both the House and the Senate have stated that they intend to make these provisions permanent. Well that hurts investment now because if the firm can get the tax break at any time in the future, they don't have any incentive to invest now. If they only get the tax break for the next year or two, then they have a big incentive to invest now. Even hinting the provision is going to be permanent is hurting the stimulus and the environment to invest.

The right thing to do here is obvious. Aid to the states, to the money back into the economy, it would also dovetail nicely with a wide variety of what I think are social policy concerns. Concerns relating to education, healthcare, homeland security, etc… So I think a lot can be done in the short run and the long run with an increase in aid to the states.

The other policy here is to get money in the hands of low income households who are much more likely to be living paycheck to paycheck, and therefore would be much more likely to spend any additional dollar they get then high-income households.

In the long run, the problem is not the use of capacity, it's the level of capacity. The way you increase the size of the economy in the long run is to increase the level of capacity, as was discussed in the earlier session, in particular in Senator Harkin's questions, once you think of capacity very broadly here to mean not just physical capital but human capital, public infrastructure, rules of law, etc. Tax cuts can have effects on long-term growth in both directions. By cutting tax rates you can encourage people to work, but by raising their after-tax income you discourage them to work because they get more money for doing the same amount of work after the tax cut than they did before the tax cut, so they may well cut back their work in the same way that lottery winners cut back their work when they get a wind-fall gain. In addition, tax cuts that provide windfall gains to existing shareholders or asset holders, increase consumption and thereby reduce the amount that people save. And tax cuts that increase the budget deficit reduce national saving, which reduces the capital stock owned by Americans, and thereby reduces future national income.

The net affect on economic growth depends on the balance between these various impacts, and every study I've seen suggests that when these criteria are applied to the current tax cuts, the balance is negative. That is, although the tax cut is called a "job and growth package," this moniker is extraordinarily misleading, especially in the long-term.

In the long-term, the tax cut, especially if it's made permanent, would reduce jobs and would reduce growth—this is the outcome of a study from the Joint Tax Committee that explicitly includes macroeconomic feedbacks, the basic reason why, and we can talk about this more if you want, is that the tax cut does not provide strong supply-side incentives, it does not provide very big cuts to small business, and it does not get the improvement of the allocation of capital that was hoped for with corporate tax integration, in fact it will increase tax sheltering. On top of that it will reduce national saving because of the increase in budget deficits and, if I can close on one last point, a lot has been made of the fact that this tax cut would boost the stock market. That is a helpful thing in the short run, because as people's wealth goes up, they spend more, but if the boost in the stock market is permanent, they continue to spend more, which means they continue to save less, and that's a further reduction in the national saving which will come back to hurt us in the out years of this program.

So, in closing, I think its difficult to design a tax cut that actually doesn't work in the short run or in the long run, but I think the administration has accomplished that feat.

<u>Senator Dorgan</u>

Mr. Gale, thank you very much, the presentations by the three of you are an interesting… (portions of this sentence are recorded over, beginning again here) we had, previously by our two previous witnesses, Mr. Reich and Mr. Kemp.

The reason that we decided to hold a hearing on the issue of jobs, was that the jobs issue really is at the center of how the American family is doing in many ways. When families sit around their supper table, they talk about their lot in life. It starts with, "Do I have a good job? Does it pay well? Does it have benefits? Do I have job security?" It goes from there to the other questions: "Do we send our kids to schools we're proud of? Do grandpa and grandma have access to decent healthcare? Do we live in a safe neighborhood?" All those are important issues, but most of what providing for the family is about is someone having a good job with job security that pays well, and so jobs are at the root of the economic expansion of people's confidence in the future, and that's why we wanted to have this hearing specifically on the issue of jobs. What creates jobs? What kind of, what set of economic policies help create an expanding economy that creates jobs? Now you can have an expanding economy that is a jobless expansion; that provides precious little confidence to the American family, however, and so I think your presentations have really added a great deal to the discussion that we've had today already.

I'm going to have to depart, so I'm not going to be able to ask questions. I've asked Congressman Spratt to take the chair if he would and continue the enquiry with Congressman Scott and my colleague Senator Harkin. Again, I regret to have to do that, but this has been a great hearing and I think your contribution to it is significant. Congressman Spratt, thank you for taking the chair as I depart. Why don't you proceed. Thanks.

Congressman Spratt

Senator Harkin, let me turn to you and ask you if you have questions to begin.

Senator Harkin

Thank you very much, Congressman Spratt, thank you again for your great leadership on the House side trying to hammer out responsible budgets, budgets that meet the needs of our people but that understand the long-term affects on our economy. I just wanted to publicly compliment you for that and pay my respects to you in that regard.

Again, I just echo what Senator Dorgan said, this was a great add-on to the previous two witnesses that we had. I just have some more specific questions for you experts. For you, Mr. Gale, one of the problems I have, and maybe it's not really a problem, but address yourself to it, what possibilities are open now for creating tax shelters, corporate types or other types of tax shelters because of a fifteen percent rate on dividends? Is that a concern or not, where people would shift if over because it would be at a lower rate than ordinary income?

Mr. Gale

The previously existing opportunities to shelter income are still in the code because all of the sheltering/anti-sheltering provisions that the Senate put in their bill were taken out in conference. On top of that, cutting the capital gains to fifteen percent basically makes corporations an even more effective sheltering device than before because it used to be that the one hurdle, even if you could shelter the money at the corporate level, there was still a hurdle of how do you get it out, it was taxed either a capital gains, a twenty percent… (recorded over) income. Now, even that hurdle has been reduced, and at the personal level, of course, cutting the capital gains rate relative to the rate on ordinary income also encourages people to shift the form of their income at the individual level into capital… (recorded over) rate on that form of income since the 1940's, and I think we've learned over… (recorded over) the capital gains rate significantly, you open up more opportunities for sheltering, so I think the opportunities for sheltering are increased under this tax law, than they were on the prior law.

Senator Harkin

And that being the case could we not see another wave, sort of, of what I call "bubble investing," sort of investing in things to take advantage of this over the short period of time, these lower rates. I'm thinking of, for example, when we had the beneficial tax write-offs for buildings back in the 80's and early 90's and then we found that we had all this capacity, it really wasn't responding to the market, it was just people trying to shelter taxes. We had this big boom in building office buildings and some of them are still vacant today and they got sold of at ten cents on the dollar and a lot of people lost a lot of money. So I'm just wondering, could this kind of tend to lead to that again, in other words "unwise" types of investments?

Mr. Gale

I think the answer is yes, the basic problem with the system of corporate taxation before this tax bill was that some corporate income was taxed twice but some of it was not taxed at all…

Senator Harkin

That's right.

Mr. Gale

…some of it was taxed once, either at the corporate or individual level. The right way to fix that problem is to tax all of the income once, at the same rate. That's not what the tax bill does, what the tax bill does is just chop the rate on dividends which may be corporate income that was taxed at the corporate level or may be not, but it doesn't do anything to level the playing field between sheltered corporate revenue and unsheltered corporate revenue.

Senator Harkin

I don't know what the percentage was. Was it twenty percent? Maybe twenty, totally. And then you think about what it does that actually affects that economy, maybe even less then that. So, that being the case are we trying to involve the Federal government in creating all these kinds of tax schemes which may lead to unwise investments, may lead to more waves and bubbles in the future eschewing, really eschewing, of kinds of investments? Or should the government be using its resources in terms of societal investment, a societal investment in education?

I was looking at the John Kennedy speech that someone put in our thing here that Mr. Kemp is always referring to and it is interesting that the first thing he mentioned was we can and must improve education and technical training, the undersupply of highly trained manpower, the development of our natural resources. Interesting that he would mention that first that perhaps we ought to be focusing on investing in the infrastructure of our country in terms of human, education, scientific research, medical research. The infrastructure that we think of reducing traffic jams for people in this country; energy investments that are more homegrown that tend to provide for cleaner energy but also for energy that is produced here. What I call the veins and arteries.

Again, I will close on this little comment; I will always think that Henry Ford had a great idea, how to mass-produce the automobile so that people can buy them, so that everyone can own an automobile. But they would not have gotten very far unless the government would of taxed people to build roads. So I think should we be thinking about the government then in terms of how the government uses its resources to invest in the infrastructure so that the capitalist system can build on that and make more wise investments. I am just throwing it out for whoever.

Mr. Zandi

Well, I will take a crack at it. You know, it is hard to argue with what you say, I mean, are comparative advantage as a nation is our people in the educational level, skill level of our people. And to invest in our educational system is, it seems to me, to be fairly straightforward: The more we invest the greater return we are going to have in the long run. So I think what you say makes a lot of sense. I do think though however it won't help the economy now, quickly. And I think it is important to realize the economy is struggling very significantly. Its eked out some growth in the last year in terms of top line GDP but outside of that you are hard pressed to really point to anything of significant accomplishment and certainly the job market, things are eroding. And in fact, its not hard to construct fairly dark scenarios about how things can unfold if we don't have a little bit of luck and the policy making that you all have done here and the Reserve has done over the past couple of years don't reach some benefits fairly soon. So I think at the moment unfortunately we need to be focused on the here and now and what can we do to help this economy over the next six, twelve, eighteen months. And I don't think that investing in more schools or infrastructure will get that job done fast enough. I mean just think about the mechanics in doing what you are proposing. If you are going to do it right it takes time, it is a process. It will take if not several months several years to get that into the economy and get it going but so we need to think about, you know, what can we do to get this, to essentially jump start this economy. And I am not sure your proposal would get there fast enough.

Senator Harkin

Fair Enough

Mr. Mishel

Yeah I think, complementing on what Mark has said which is we need to think about long term growth as well as short term growth. And in terms of long-term growth I think that you are absolutely correct. And in fact I think we will very much regret these tax cuts we have seen this year and over the last few years because it is going to erode the revenues available to in fact do the kind of public investment that we are going to need. And I think that the business sector is going to regret it as well as a lot of other people cause it is going to be an actual impediment to growth. Bill Gale told me earlier that we had an estimate that we are going to lose roughly, is it 2.7% of GDP in terms of revenue around ten years from now because of the accumulated effects of all of the tax cuts that we have had. That is basically the Federal sector will have ten, fifteen percent fewer revenues. And if that comes out of the domestic discretionary budget that is a very large cut in what is available to do the kind of public investment that you are saying.

Now I also agree with Mark that we have to think about what we are going to do to create jobs right now. And frequently, I mean, there used to be a time when public works or public sector employment programs were proposed and people said that did not work. And the criticism of doing public works, getting more roads, bridges done is that it takes time. I think that it is not as apt to criticism right now as it would have been at another time for the following reason: if you look at the tax plan that was just passed a lot of the money is spent in fiscal year of 2004. If we went, if we said right now that we had 25, 50 billion dollars available for schools or bridges; I could tell you that most school districts, states, cities have plans for schools that they wanted to do that they have scaled back on. They don't have to go to an architect; they don't have to do anything to sort of renovate schools. We could put money into these kinds of buildings and school renovation and we would get the jobs and we would not have to wait too long.

I agree with you, Senator, that when you have this kind of government expenditure as a part of stimulus not only do you have less leakage to imports but governments don't save. Right, if you give money to a consumer some may save, you know some off what they get and spend. Some of what they spend leaks out because they buy imports and it doesn't stimulate the domestic economy. So directing toward public expenditure, public investment is probably one of the most stimulatory acts the government can do to create jobs and it won't be jobs necessarily in the next six months but definitely would happen by a year, year and a half. Which is why you also need to compliment that kind of strategy with some immediate tax relief. Similar to what has been proposed by Democrats in the Senate and the House. $300 dollars per person per man, woman, and child; something like that right now, not waiting for 2004, right now. That will get spent and that is why I think a balanced package of some immediate tax relief and some public expenditure. One-time policies, things that don't affect the deficit in the long run; spend a $150, $200 billion dollars, you know, right now we could of created a lot more jobs then anything the Bush plan will likely do.

Senator Harkin

Like Mr. Zandi, you suggest a payroll tax holiday?

Mr. Mishel

I have my own version of that but it is something that basically provides money to people who are going to spend it, target at low income, middle-income families.

Senator Harkin

I don't want to take any more of my time.

Mr. Gale

Thank you Senator, I think you ask a key question. The reason why is that it focuses the discussion away from should we have a tax cut, which is the wrong debate to have and toward the right debate, which is what's the best way to use this pot of money? And obviously if it is used for a tax cut it cannot be used for some other purpose like improving the school system, providing health insurance, building inner-cities, cleaning the environment, etc. In the long term, I think that the proposal for investment in infrastructure and education is sound for the reasons that my two colleagues here have mentioned and for the reason that Robert Reich mentioned earlier.

In the short term there's an issue about how fast these big public works projects, if you want to call that, can work their way into the economy. But that is not really the issue in the short term, the short term right now the states are literally cutting spending, unscrewing light bulbs, letting prisoners out, shutting schools down, and raising taxes. And money that the Federal government shifted to the states in the short term would have an immediate one to one impact on spending in the economy regardless of architects plans and stuff like that there is just avoiding the spending cutbacks and avoiding the tax increases would be an increase in spending and a reduction in taxes relative to what otherwise would have been. So I think there is a substantial amount that the Federal government could do immediately along those lines with very beneficial short-term effects.

Senator Harkin

Thank you all three very much. Thank you for you indulgence.

Congressman Spratt

Thank you very much Senator Harkin. Congressman Scott

Congressman Scott

Thank you, Mr. Mishel I have been intrigued with this chart that you have for job growth up to the election of 2004. It is my understanding that if you read the President's Council of Economic Advisors report, the whole thing, has starting things after the election. And in fact, in fact my reading is that in a couple of years after that you're going to be seven hundred thousand jobs worse off then had you done nothing.

Mr. Mishel

Well, Mr. Scott I think you're right that when you look at estimates, for instance that my colleague Mark Zandi has made, that in the long run the Bush plan will actually yield fewer jobs in the economy ten years from now then if we had not passed the tax policy.

Congressman Scott

Isn't that what the President's Council of Economic Advisors said in their report?

Mr. Mishel

Well, they essentially report that there will be some job gains over the next two years. And some of that is borrowed from the future. They don't go out ten years probably because the models they use which so exactly what in fact you demonstrate. What I am saying is that we can actually judge the failure of success of this plan over the next two years without waiting ten years.

Congressman Scott

Well, my point is that if you believe the one point four you also ought to believe the minus seven hundred thousand. Which is absolutely consistent with the joint committee on taxation analysis that there is a short-term spike but in the fullness of time you are worse off then you were had you done nothing.

Mr. Mishel

I think that you are absolutely right. What's even more disappointing is that I don't even think that they are going to get the bump up before they go down as much. So I don't think we'll see the short, we are going to have long-term pain and I think we will get very little short-term gain especially for the amount of money being spent as Bill Gale said.

Congressman Scott

Well, let me ask Mr. Gale what if you are going to get a bang for your buck what could we have done better then the tax cut package?

Mr. Gale

The two sort of most striking obvious candidates to me are aid to the states for the reasons I discussed before, but let me just mention would not only have a short-term stimulus, it would be providing assistance for things we care about in the long term like education, health, homeland security, the environment, inner cities, whatever. So it might be a plus in the short run and the long run and the other way to stimulate the economy in the short run is to put money in the pockets of people who are most likely to spend it and that is going to be households that are living paycheck to paycheck at the lower end of the income scale. It is very unlikely that a dollar going to an extremely high-income household is likely to generate an increase in spending.

Congressman Scott

Mr. Zandi you made a similar report on the kinds of things that would most likely result in improved job situation. What are the most cost effective ways you can do that?

Mr. Zandi

I agree with Bill that aid to the state governments is very efficacious way of stimulating economic activity quickly because the programs are in place and all you are doing as soon as you cut a check to the states they will cut a check to their beneficiaries.

Congressman Scott

And if we don't they are going to have to lay people off which is not helping the situation.

Mr. Zandi

In fact of the $350 billion dollars plus plan that was passed, twenty billion is to state, some form of state aid, and I found that to be the most important aspect of providing that near term boost to the economy. So that was very efficacious. But I think the thing to realize about the plan was passed is that it does nothing to directly effect the willingness or ability of businesses to hire people. I mean it is all directed towards either stimulating demand, consumer demand, or lowering the cost of capital and making it easier and cheaper for businesses to invest in capital and equipment. So I mean if you were really interested in stimulating payroll, hiring you would design policies to lower the cost of labor relative to capital and the most obvious thing would be some kind of payroll tax holiday, I mean you get a big bang for the buck from that cause you are giving a lot of money to generally less well off people. People who would benefit because they don't pay income tax anyway and then also you are lowering the cost of labor at the same time. So, I think the next stimulus plan, and hopefully we won't need it, hopefully the economy will turn as anticipated but if we do need one I think the next plan should be designed around lowering the cost of labor for businesses not the cost of capital.

Congressman Scott

Healthcare?

Mr. Zandi

And that is the most obvious thing. I mean I think that people don't realize that when businesses decide to hire a person they don't look at the current premium they are paying. They are looking at the present discount value of all the premiums they are going to pay for that person at (incoherent) in the future and I am a small business owner. I have seventy five employees in Pennsylvania and if I do that calculation based on ten percent premium increases over the past three years, and I am like the average business person and I extrapolate that out, that becomes a pretty hefty bill pretty quick and I am gonna be cautions in hiring a full time employee.

Congressman Scott

What is the impact of a long-term structural deficit in the budget?

Mr. Zandi

Well that's how you get those negative numbers in the long run because when you run long persistent budget deficits you generate higher long-term interest rates. When you generate higher long-term interest rates it's a very pernicious effect on the economy.

Congressman Scott

And long-term interest on the national debt?

Mr. Zandi

Absolutely

Congressman Scott

Mr. Gale, Mr. Mishel do you want to comment on the effect of the long-term deficits

Mr. Gale

I just want to add one point. What deficits do is reduce the amount that the country is saving. That is the government borrows more that reduces the combined sum of government and private saving. Just like when a household saves less, it has less future national income the same things applies to the nation as a whole. The nation saves less; its future income is lower. Mark made a comment that it would raise interest rates, I personally agree with that statement that deficits will raise interest rates but the point that I want to make is that even if they don't raise interest rates, even if deficits are completely compensated for by capital inflows from overseas and the interest rate does not change. They still cause long-term economic damage because we still have saved less and we still have less future income. If there is a massive capital inflow that keeps the interest rate flat that means the amount of output produced in the country will stay the same, but our claims on that output, as Americans, will have fallen because we saved less. The equivalent will be a family who borrows a lot of money on their credit card. The credit card company might raise the interest rate or it might not but either way that family faces huge repayments on the future that reduces its future disposable income. So although I think the interest rate issues is important the really fundamental issue that budget deficits reduce our national saving regardless of the interest rate effect.

Mr. Mishel

Well, I would add that creating chronic deficits, as this tax plan will do, is problematic for long term growth, but I think it's unfortunately sometimes hard for the American people to understand that sometimes a higher deficit can be good and sometimes it can be bad. We are saying that the kinds of deficits that are bad are when it's chronic into the future. That even when we get to a place where we have full employment we will still have high deficits. I have to agree with the president that at a time of war and recession that is a time when you want to run a deficit. And having a somewhat higher deficit right now is appropriate and that is why plans, which raise a deficit in the short run but don't lock us in for the long run are very important to do but unfortunately I think that it is very hard to articulate that in a political debate. In this country for people to understand that its not just pro or against deficits, its at what point in the business cycle you are whether you want to have a larger deficit or not.

Congressman Scott

I think we have suggested short-term stimulus that did not have long-term deficit effects. Temporary unemployment compensation, temporary accelerated depreciation, temporary aid to states. I mean a number of things that don't lock you into long-term deficits that will have the stimulus effect. Thank you Mr. Chairman

Congressman Spratt

Thank you very much Mr. Scott and let me thank all three of you for an excellent contribution to our effort this morning. Let me start with Mr. Mishel. I think your particular paper is very basic to a whole situation right now unless we establish some kind of yardstick or metric as you proposed and we are going to have in a few months a domestic redux of the WMD argument we are having today. What was said and what was claimed and against which bates line do we measure the growth in jobs because we all hope that this economy is gradually gathering steam and about to get back on its feet particularly with respect to job creation. I would ask you are you letting the administration off rather easily with this proposed yardstick?

Mr. Mishel

Well thank you for the compliment first. I agree it is very important to have a yardstick or else we will run into the same problem as we are seeing about the weapons of mass destruction. Well this is not the only yardstick against the administration's economic policies can be judged. This is the yardstick for judging whether in fact they have fulfilled their promise to create 1.4 million jobs on top of the jobs that would be created anyway. Even if they were to create the 1.4 million jobs in addition to the 4.1 that they said would be created anyway there is still the issue of the fact that we are now down three million private sector jobs from when this recession began. Now that is not all the fault of the Bush administration but it does seem to me that their main policies, which is a round of tax cuts again and again, has not been the way to effectively address the shortfall of jobs. So let me just say this, when they get their report card this is just one subject, there are other subjects.

Congressman Spratt

We got a chart somewhere I believe that shows the job creation achieved in the different administrations for the last several decades.

-Mr. Mishel-

Yeah, Mr. Spratt as an economist I tend not to do it by presidential administration but when I have looked at this according to business cycles . . .

Congressman Spratt

We are not trying to politicize this

Mr. Mishel

No, I understand. But I would say even if you look at this and I have a similar chart that you can go back to the 1930's. This business cycle was started in March 2001. We have lost 2.7% of our private sector job base. There is no downturn since the early 1930's where there has been anywhere close this contraction of private sector employment. So, that to me is very problematic in terms of families be able to get jobs, get higher wages, and maintain their . . .

Congressman Spratt

So even if the administration achieves the yardstick you have laid out for them which is 4.1 million jobs already projected to be built into the estimate of the near term future plus 1.4 million resulting from their stimulus tax cut. That's about 5.5 million jobs over the next 16 months. And when you net that out against the jobs that have been lost over the previous months in this administration you come out with about 2 million net jobs.

Mr. Mishel

It would be a very disappointing job growth and especially in percentage terms because don't forget in the 1950's and 60's there was a much smaller job base. So to get, you know, create seven million jobs or eight million jobs is much larger percentage gain then if you were to create seven million jobs now. So, in fact to create two or three million jobs over the course of the administration would be really a poor record compared to any administration back to Hoover.

Congressman Spratt

Well Clinton inherited what was a jobless recovery and it began to take speed about the time he came to office again not all due to his policies it was scheduled to do that. But still in the first four years his administration saw the creation of over ten million jobs--the second four years the same. So this would put George Bush in about the class of his father for the four years of his administration, which is compared to all previous administrations is a rather low level of job production.

Mr. Mishel

One of my other areas of work is education policy research, where we are holding schools accountable. And I think that not only schools need to be held accountable. I think we need to be able to grade the administration on its economic policy, and I think this is the main measure, especially because this is what they've touted as their measure of success. They are going to create 1.4 million jobs. I take that very seriously because I think we really need the jobs. I think people are really hurting out there and what I guess has bothered a lot of economists is that this claim of short-term stimulus from the packages that they have proposed doesn't seem to ring true--that they have been arguing that this is a job creation plan when in fact it is really a plan about taking away revenue from the government in the long-run.

And another plan is to shift taxes away from taxes on financial wealth and to only have taxes on wages. It's not being conspiratorial to say that; they have been very articulate in testimony and in written documents saying they don't want tax capital anymore they only want to tax wages. I think the American people understood that they would have a lot better feel for what these tax plans are all about.

Congressman Spratt

The other point that you made that I thought was particularly valuable was to emphasize how the 6.1%, which does not sound terribly drastic compared to previous post war recessions, is actually worse when you look at the growth of real household income, the growth of disposable income, the negative growth in both of those categories. Anecdotally what I see and I think you see in your own data is the amount of underemployment and the numbers that don't get represented in the denomination of this fraction anymore people who have given up the search for jobs. The picture is actually worse then the 6.1% would suggest.

Mr. Mishel

Well I think that you are absolutely right and I think that it's important that we move the goalposts. The goalposts used to be getting the unemployment down to 5.5% or 6%, but we proved in the late 1990's that we can get to 4% without inflation. We had a period of broad based prosperity. Income grew among each racial group--among low-income, middle-income, and high-income families. So 4% should be the target and the fact that we are at 6.1%, that means we are way off target right now.

Congressman Spratt

All of you seem somewhat concerned that in the longer this recovery may be sluggish itself, it won't be the optimum rate that we would like to see resulting from the rebound in the economy. And one reason is that the cost of this so called jobs and growth package is likely to be more then the price tag, 350 billion, if the sunsets are removed, which they inevitably will be and the tax provision included in it don't expire the gross cost is, by our calculation, about a trillion dollars in revenue lost. And if you add that to other expected tax cuts that are coming down the pike like the fix and AMT, the alternative minimum tax, which is politically inevitable in some point in time that is another 600 billion dollars. What you got is a huge load of debt and deficits that are going to have to be financed and according to the Fed's recent study a 100 billion dollars of additional deficits could drive up interest rates by as much as 60 basis points. Do you agree with that Mr. Zandi? Have you seen the study, do you agree with that basic rule of thumb?

Mr. Zandi

Yeah, I do. Twenty-five basis points for every one percent deficit sustained deficit equal to one percent of GDP. I think that sounds about . . .

Congressman Spratt

Every one percent of GDP that the deficit represents is a twenty-five basis point in . . .

Mr. Zandi

Sustained deficit. Meaning (incoherent) into the future. So right now it is about 100 billion dollars

Congressman Spratt

Would you say that because as these numbers become more and more real and less and less hypothetical is we begin to book deficits of over 400 billion dollars at the end of the year that no longer becomes projected or predicted or hypothetical but it becomes real and people start licking as they haven't been doing closely enough at the out years that the markets will begin to believe these are structural deficits as opposed to cyclical deficits?

Mr. Zandi

Yes, I think that will be the case. I think interest rates, real long term interest rates will ultimately rise once we get beyond many of the other factors that are effecting those long term interest rates currently.

Congressman Spratt

And is that the attitude that drives up interest rate in based upon . . .

Mr. Zandi

I don't think the market is fully focused on the reality of the situation but I think you are right as we get out in the middle part of the decade and the reality becomes more of a reality then the market at some point will focus on it and we will see higher long term interest rates as a result of the large budget deficit we experience.

Congressman Spratt

You suggest the other stimulants in case they are needed and the one that you put front and center was an increase in the unemployment insurance benefit particularly extended benefits in particularly those who have exhausted their benefits in this longer prolonged recession. I believe that the economy.com developed a multiplier for that. It has been used often in the debate in the House mainly for that every dollar of extended unemployed benefits we provide we get a $1.73 in economic growth. Can you explain that?

Mr. Zandi

I am impressed; I did not even remember the exact down to the penny

Congressman Spratt

Oh we have memorized it.

Mr. Zandi

I will have to be very careful with those pennies. Yeah that's probably the most efficacious policy you can implement. Meaning, you will get the most bang for the buck providing that kind of benefit to what are clearly very hard pressed households. They live obviously paycheck-to-paycheck, benefit-to-benefit; and if you give these folks some help they will spend it immediately and it will find its way into the economy and work its magic very, very quickly. So there is probably nothing that you as a fiscal policy maker could do that would give you a bigger bang for the buck then just that to provide more help to these very hard-pressed households.

Congressman Spratt

Mr. Gale, do you agree with that? And is the tax package that just passed, the so-called, what is it?

Mr. Gale

JGTRRA.

Congressman Spratt

Is this package providing us anything like a $1.73 of economic results for every dollar that we give up in revenues?

Mr. Gale

I certainly have no disagreement with economy.com rankings of the various policies, which I think have proven very useful in the public debate. This tax cut is certainly not designed with short-term stimulus in mind. It's basically an acceleration of tax cuts previously enacted that mainly accrue to high income households plus a cut in the dividend and capital gains tax cut which also accrues mainly to high income households. It doesn't sort of follow any of the principles to what an effective stimulus would be. An effective stimulus would have a big bang for the buck immediately. That is people would spend the money so that means either getting it to low income people via some sort of tax cut or unemployment insurance benefit or getting it to state. And an effective short term stimulus would not have an implied long term cost of a trillion dollars, as you mentioned, because that to the extent that the market thinks that those policies are going to be made permanent and that is going to drive up interest rates and stall the recovering now because markets are forward looking. So this is not a package that is designed, as far as I can tell, to stimulate the economy. As far as I can tell that language was to basically mask what was essentially a supply side tax cut.

Congressman Spratt

You have been an advocate a long time and you have come forward with specific proposals for simplifying the tax code. It's been a long time since 1986 when we really gave the code a scrub down. And it seems to me the administration had an opportunity with its claim that there was double taxation of corporate dividends. They could of proposed a solution that was a true solution unlike the one that was ultimately passed and then used it as an incentive to clean out the closet, so to speak with respect to the corporate tax code which is full of deductions, and credits, and exemptions, and preferences, and lord knows what else. And toe corporate America, here it is, this is a prize. If you will agree with us on broadening the base, we will bring rates down and this will be the ultimate reward. We can pass this but we got to make it deficit neutral. That is the way it was proposed originally by Glen Hubbard, the former CEA chairman when he was working at the treasury department and sort of worked out the elements of this proposal. He proposed that it be deficit neutral. Do you think this was an opportunity that was blown?

Mr. Gale

I think along those lines there was a tremendous opportunity that was missed. I think that almost all economists would agree that a system whereby you tax all corporate income once and only once at that same rate would be a much better system then the system that we have. Now because some corporate income is taxed twice and some corporate income is not taxed at all you have an opportunity there to bring up the non-taxed, or sheltered income, to be taxed once and bring down the double taxed income to be taxed once. And thereby get a broad based, low rate integrated system. The Treasury report in 92 and other studies that have been done suggest that this can be done on a revenue neutral basis. The fact that the administration didn't do that suggests to me that is not fundamentally what they were after. What they were after, what they proposed was a tax cut for high income households using the veneer of corporate integration as the excuse. But of course ultimately when push came to shove they were willing to drop all the corporate integration provisions and settle for the tax cut for high-income households. So I think that this was an ideological push to reduce the tax basis Larry Mishel mentioned and starve the government but it could have been structured differently. It could have been structured as a revenue neutral way of improving the efficiency, equity, allocation of the corporate income tax.

Congressman Spratt

Let me ask all of you one final question. Have you had the opportunity to look at CBO's analysis dynamic scoring of the proposed tax cut which came to the conclusion that the dynamic effects are not dramatic, in fact they can actually end up losing revenues (incoherent) at a loss of revenues more then these static projections would apply? Do you agree with that analysis?

Mr. Gale

I have looked at it very closely. I have served a advisory member of the JCT panel on dynamic scoring so not only have looked at the CBO analysis carefully but I also talked with JTC about this extensively. A couple of points to make, one is that CBO analyzes the President's entire budget not just the tax proposal. The JCT however has analyzed just the House proposal, the bill that passed in the House, which is essentially what got passed in conference but on a permanent basis so its fair to attribute the JTC analysis to the permanent extension of the 2003 tax cut. There I think the analysis is sound. You know models always have umpteen assumptions that can be made. I think JCT generally makes pretty reasonable assumptions. I think CBO makes relative similar assumptions but I don't see anything in those reports that suggest that they aren't mainstream analysis. I know estimates by other macro-economic consulting firms sort of generate similar qualitative results and these results are consistent with economic theory as well. So I wouldn't swear by any particular number in any of the studies but I don't have any reason to doubt the general pattern of results that has emerged.

Congressman Spratt

Mr. Zandi, I understand that among other things that they look at the ideas and when they see the accumulation of debt and deficits they come to the conclusion that this is bound to have the effect on interest rates, which will diminish growth.

Mr. Zandi

That is right, the CBO study was well crafted, I thought, a comprehensive study. But it is also important to realize the limitation of all models. I mean, even if we did what Bill suggested and taxed all of corporate income once and ran that through these models its very likely we would see small positive net supply side effects as well. And I think most economists would agree that they probably underestimate the supply side effects. I am not suggesting the CBO results are not valid and useful. I am just saying that you need to think about how the limitations of the models that we use as economists and put them in some kind of context.

Congressman Spratt

Mr. Mishel

Mr. Mishel

I agree with my colleagues and just to comment a little more on the short-term results, which these various models show that there would be some job creation and some benefits to economic growth in the short-term but nearly all of the benefits come through Keynesian demand side mechanisms. There is a lot of supply side rhetoric but when the actual models are employed it really comes from giving people money to spend it. Not through any of the mechanisms that Mr. Kemp was talking about earlier today. All about raising the rate of return and making it more incentive to work. All those mechanisms are not really where the growth comes from in any of these models that we are talking about today. It comes from giving people money who are going to spend it . . .

Congressman Spratt

Restoring demand which is deficient now

Mr. Mishel

Yeah, absolutely. It's all that, so I just thought that was noteworthy.

Mr. Gale

Can I elaborate on that for just a second? The models include the supply side channels, but if you use estimates of the supply side responses based on the literature, the economic literature, you don't get very big effects. A colleague of mine, Charlie Schultz, who was the CEH here under President Carter, says that there is nothing wrong with supply side economics that by dividing by ten doesn't take care of. And that is basically what these models show. That there are effects they are just nowhere near as big as advocates would like them to be.

Congressman Spratt

Thank you all for excellent presentations and for your perseverance and forbearance in staying with us till the end of this hearing. You have made a great contribution to our understanding of the problems we have to deal with. Thank you very much.