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Douglas Holtz-Eakin

Slaying the Dragon of Debt: Fiscal Politics and Policy from the 1970s to the Present

A project of the Walter Shorenstein Program in Politics, Policy and Values

Interviews conducted by
Patrick Sharma and Martin Meeker
in 2011

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Table of Contents—Douglas Holtz-Eakin

Interview #1 February 7, 2011
Begin Audio File 1 02-07-2011.mp3

01-00:00:00
Sharma: I just want to start with asking you how you became interested in issues of public finance and budgetary issues more generally.

01-00:00:09
Holtz-Eaton: I grew up in Pittsburgh. My dad was in the steel business and so I was always keenly aware of business cycle phenomenon and ended up going to graduate school to study economics. This was 1980 and we were going through yet another round of economic difficulties in the US, headed into a very sharp recession and there were continual discussions of budgetary stress, particularly the state and local governments, and I ended up writing my dissertation on that. And I've always been interested in public policy and budgeting just came right along with it.

01-00:00:46
Sharma: Can you describe a little bit about the ideas that animated your dissertation and your conclusions?

01-00:00:54
Holtz-Eaton: In economics, there's a standard piece of economic modeling, which is the permanent income hypothesis, which means a household behaves this year on the basis of what it sort of expects its lifetime resources to be, not just what's coming in the door this year, which explains why graduate students who make no money live better than they should and then pay it off when they get jobs. It always struck me as odd that governments, which are supposed to be smarter and better, seem to be the most caught by business cycles. And so the whole idea was, well, if the guys running governments are the same people who at home are doing this, maybe they're running their governments on the basis of more permanent measures of their resources and shouldn't be so influenced by business cycles. So is it their lack of foresight or is it the rules that are forcing them, balanced budget requirements, things like that?

01-00:01:44
Sharma: I see. Okay.

01-00:01:45
Holtz-Eaton: So it was just trying to test those things out.

01-00:01:47
Sharma: In addition to the business cycle problems in the seventies- the sort of long decline of the US rust/industrial belt- there was massive inflation. Did that animate your thinking?

01-00:01:58
Holtz-Eaton: My fields of concentration turned out to be public finance, tax and spending decisions by governments, monetary theory. So what are the monetary policy

issues? And then the third was economic history, where you learn that we've done all this before. [laughter] One more time.

01-00:02:20
Sharma: How did you read the inflation of the seventies, both at the time and then in retrospect, how do you see that?

01-00:02:27
Holtz-Eaton: Well, I, like most people my age, grew up with it and so I didn't find it all that remarkable until I started studying. It was just sort of—in the same way that standing in line for gasoline. I didn't know just how irrational and stupid that was at the moment. But part of an education is to find out that, "Gee, this is really a big deal."

01-00:02:50
Sharma: It's not particular to—

01-00:02:51
Holtz-Eaton: We don't have to live like this.

01-00:02:53
Sharma: Yeah, okay.

01-00:02:53
Holtz-Eaton: That was more of a post-graduate school experience.

01-00:02:58
Sharma: Okay. And then this notion that we've come across in some of our research, that the inflation of the seventies was in some ways attributable to federal budget deficits. Was that something that was percolating?

01-00:03:09
Holtz-Eaton: That wasn't animating me but it certainly was the case that there was this just almost Hatfield and McCoys within economics war over how you constructed economic policy. And the basic issue was that the sixties and seventies had been characterized by active discretionary policymaking, both cutting taxes, raising spending, expanding the money supply, lowering interest rates. Whatever levers you want to characterize, the regime that had been used was one that every year something was trying to be done to micromanage the economy and control the business cycle and there was a widespread perception of failure and there was this rational expectations revolution in economics which was saying not only doesn't that work, it can't work, it won't work and so you should conduct policy based on rules, constant feedbacks between the level of growth and the money supply or constant feedbacks between the business cycle and unemployment insurance, automatic kinds of stabilizers.

01-00:04:16
Sharma: Okay, I see.

01-00:04:18
Holtz-Eaton: And so this is one of the great ironies, actually, of this moment in history to me is that we seem to have forgotten the lessons of the sixties and seventies because we're right back to very activist policy regimes. One of my great trepidations about what's going on right now budgetarily is all you hear about is we're going to have a stimulus package for this and a tax cut for that and a stimulus package for that and over here the Fed's going to do quantitative easing 17.6 and it'll all be fine and they're all wrong. [laughter]

01-00:04:46
Sharma: And to—probably—

01-00:04:47
Holtz-Eaton: And we've seen that movie before and—

01-00:04:49
Sharma: I'm probably going to oversimplify this but this is wrong in your view because people will adjust their expectations—

01-00:04:54
Holtz-Eaton: People will adjust their expectations.

01-00:04:54
Sharma: —accordingly and therefore it's not so easy to program their behavior.

01-00:04:59
Holtz-Eaton: Number one, they adjust their expectations and so you no longer fool them into thinking that this is new or different and thus they can spend based on it. And number two, the government's just not that competent. And I don't mean that maliciously. It's a $15 trillion economy and the idea that you're going to manage it effectively is just very misplaced in my view.

01-00:05:17
Sharma: I see. Can we talk a little bit after you finished your PhD?

01-00:05:21
Holtz-Eaton: Sure.

01-00:05:22
Sharma: I know you wrote quite extensively and one of the pieces that I found very interesting was this piece that you co-authorized with Alan Blinder about public opinion and the balanced budget—

01-00:05:32
Holtz-Eaton: And the balanced budget, yes.

01-00:05:33
Sharma: —in the mid-1980s. How did your views on federal finances evolve, if they did at all, before you entered government in the 2000s?

01-00:05:44
Holtz-Eaton: Probably the key one was not so much that. That was an interesting sort of one off project. I've always been interested in—I said public finance, public policy, but also people's perceptions of it and that matters a lot. Comes out of that sort of expectations thing. But when I got out of Princeton I went to Columbia University. This was the first time in my knowledge, we've seen it since, where infrastructure became the favorite hobby horse and so there was the infrastructure crisis. America was falling down and *Time* magazine put it on the cover and there was some research that suggested that a dollar of infrastructure should have these enormous productivity benefits. This should sound familiar. We're doing it again.

01-00:06:34
Sharma: Right. The stimulus. The sort of multiplier—

01-00:06:37
Holtz-Eaton: Stimulative and long run productivity impacts, all that stuff. And so I did a lot of research on the productivity impacts of public infrastructure. If you invested a dollar in a private corporation versus in a road, what are the impacts for the overall economy relative to the long-term.

01-00:06:51
Sharma: I see.

01-00:06:52
Holtz-Eaton: And came away with strikingly negative findings. That these were, at best, no better and often much, much worse ways to spend the nation's dollars.

01-00:07:06
Sharma: Right, I see.

01-00:07:06
Holtz-Eaton: And then looked at that across states, looked at it across different kinds of infrastructure. In many ways it's not surprising because not everything we do in the government is designed to make the economy more productive. You build a park. That's not about having GDP be higher, it's about making people happier. In many cases, like if you widen roads to shorten commute times, it doesn't change what you do at work at all. Productivity is about the same but you can leave later and get there and get home quicker. So you wouldn't expect them to show up in a measure of productivity and the idea that they were going to is just wrong.

01-00:07:40
Sharma: I see, I see.

01-00:07:41
Holtz-Eaton: But people were claiming, essentially, if we spend the money we will grow faster. It was sort of the same kinds of arguments you're hearing now.

01-00:07:50
Sharma: I see.

01-00:07:50
Holtz-Eaton: There wasn't any there, there.

01-00:07:52
Sharma: Right. We spoke to one of our earlier interviews about the difficulty of finding actual productive projects to spend the money on as one of the sort of underexplored aspects—

01-00:08:00
Holtz-Eaton: It's an enormous—yeah.

01-00:08:00
Sharma: —of the issue.

01-00:08:03
Holtz-Eaton: And I just wrote another paper for the National Transportation Policy Project. Here we are. I wrote the first one on this topic in 1985. Twenty-five years later, same papers. [laughter]

01-00:08:20
Sharma: I'd be interested in the stalemate.

01-00:08:20
Holtz-Eaton: Some things don't change.

01-00:08:21
Sharma: That's certainly one of the more interesting features of sort of the recent history of budgetary politics, is the long running stalemate. I think you're thinking about it much more concretely, pardon the pun, but in a more macro perspective, the sort of stalemate between Republicans and Democrats, stalemate over spending, maintaining its accelerating pace and the continual pressure for tax reduction. Maybe let's get back to that—

01-00:08:49
Holtz-Eaton: We'll come back to that.

01-00:08:50
Sharma: —a little bit at the end. I'm interested in—during the 1980s, such a fascinating period, the Reagan era, I think especially from a fiscal perspective because you really had a revolution. How did you see the Reagan years playing out and were you concerned about the rise of the deficits? And if so, how did you think about them or to what did you attribute this accumulation of deficit?

01-00:09:16
Holtz-Eaton: So yes, you looked at the deficit and you thought, "Geez, this is terrible." And it seemed to me it was equal parts big spending ramp up, big tax cut, big recession. That's a recipe for big deficits and we got that. The Reagan administration changed course quickly. Everyone talks about the '81 tax cut.

They raised taxes in ’82 and in ’83 and ’84 there was even some tax cuts. They didn’t—

01-00:09:46
Sharma: You mean tax raises?

01-00:09:47
Holtz-Eaton: Tax increases, sorry. They did a quick U-turn. But on the spending side, it was us versus the USSR. They did not cut back. [laughter]

01-00:09:58
Sharma: I see. Yeah. Okay. So in that way it’s a fairly straightforward—

01-00:09:58
Holtz-Eaton: So that was pedal to the metal.

01-00:09:58
Sharma: —history.

01-00:10:02
Holtz-Eaton: Yeah. And it was closing but in the end deficit reduction dominated. Tax Reform Act of 1986, passed that. You get the Gramm-Rudman-Hollings, passed that. You get all the sort of nineties budget summits. It dominated everything for about ten years.

01-00:10:21
Sharma: And why do you think the concern about the deficit was so dominant then, why it actually had some traction in Congress? Was that because there were people in Congress who were just more concerned about it?

01-00:10:34
Holtz-Eaton: No. Well, number one, there were people concerned about it. You shouldn’t dismiss that. Phil Gramm, for example, was on record, very notable. Hollings from a very different perspective. Warren Rudman, classic moderate Republican. So there was some leadership there. But it was also true that if you looked back, a lot of the emphasis on getting something like Gramm-Rudman-Hollings came after the ’87 stock market crash. And there is this theory that it had nothing to do with the budget but it somehow prompted action and that the only way you get budgetary action is to have something awful like that happen. So could be true. [laughter]

01-00:11:15
Sharma: Right. We had a chance to interview people involved. After the ’87 crash there was this budget summit and it sort of seems as if there was always a tenuous understanding of the relationship between the financial markets and the federal deficit. It wasn’t clear. It still really isn’t necessarily clear.

01-00:11:31
Holtz-Eaton: I’m all in favor of fake crises to form action.

01-00:11:34
Sharma: I want to get up into the more recent past and your role in the Bush administration and then at the CBO. How did you end up as chair of George W. Bush's CEA?

01-00:11:46
Holtz-Eaton: I was chief economist. Glenn Hubbard was the chairman.

01-00:11:51
Sharma: Oh, I'm sorry. Excuse me. Right.

01-00:11:53
Holtz-Eaton: And there's a reason for that and the reason is when I was at Syracuse as department chairman I tried to hire a guy named Kevin Hassett, who I am friends with, thought he was a promising young scholar at the American Enterprise Institute. Failed in the end. Kevin went on to be the policy director for the 2000 John McCain campaign and in that role called me up a couple of times and asked me for help. I even flew down and met McCain once in Virginia. But no one should be confused about my role in that campaign. I did essentially nothing. But that didn't mean that when I was asked to be Assistant Secretary of Treasury that the White House didn't nix my appointment. They did.

01-00:12:33
Sharma: Because they remembered you from the primary season?

01-00:12:34
Holtz-Eaton: They asked me. The White House personnel—Treasury had cleared my appointment. I had met with Ken Dam, deputy secretary, and Paul O'Neill, secretary to be. They were onboard and I was excited. It was going to be great. And I went over to talk to White House personnel and a woman named Deena Powell said, "Tell me about your history, blah, blah, blah. You ever work for anyone else?" I said, "Yeah, I helped John McCain a little bit." My feeling is everyone who's Republican I can help.

01-00:12:56
Sharma: Yeah.

01-00:12:56
Holtz-Eaton: Dead. Cut him off at the knees.

01-00:12:59
Sharma: Welcome to Washington.

01-00:13:00
Holtz-Eaton: So yeah. Lesson learned. And Glenn and I are close. He knew about this and so what he did is he brought me into the CEA under the Presidential line. It wasn't a Presidential appointment so that Presidential personnel couldn't stop it.

01-00:13:15
Sharma: I see.

01-00:13:16
Holtz-Eaton: So in the great irony of things, they could keep me out of the Treasury but they couldn't keep me out of the White House. [laughter]

01-00:13:21
Sharma: Okay. And then what is your feeling about—the CEA is sort of a weird—it's an interesting institution.

01-00:13:27
Holtz-Eaton: It's the second time I've worked there. It's a very—

01-00:13:29
Sharma: Okay, yeah.

01-00:13:30
Holtz-Eaton: I worked there '89, '90, first Bush administration, and the CEA is a very interesting institution. But I had a fabulous time there and we worked very hard and obviously I was there on 9/11 and there was a lot of experiences that you never forget. But CEA is basically a think tank to the White House. You have to think of it that way and to decide what you're going to make, how you're going to market it, what policy battles you're going to play in. Glenn's ambitious and aggressive and we decided we're going to play in everything and we did.

01-00:14:05
Sharma: So can we get a little more into this because—

01-00:14:06
Holtz-Eaton: Sure.

01-00:14:07
Sharma: —we've heard competing theories about the role of the CEA and I think it changes by administration and by issue. On the one hand people saying that the CEA is a bunch of pointy-headed academics who—

01-00:14:17
Holtz-Eaton: Of course they are.

01-00:14:19
Sharma: —who will come in for a few years, usually sort of cycle through. There's not too much influence, especially when compared with, for instance, the National Economic Council that was created by Clinton.

01-00:14:30
Holtz-Eaton: Right.

01-00:14:30
Sharma: On the other, that this is actually what you described as a think tank that does have some sort of influence. What was the CEA's role in the early years of the George W. Bush administration?

01-00:14:43
Holtz-Eaton: A couple of things to remember. The CEA was created by the Employment Act of 1946 and in the Act it's got these three Presidential appointees and the White House can't get rid of that unless they want to repeal that and they're never going to. So they're stuck with the CEA. So even though when the National Economic Council was created, that's supposed to be a coordinating council that coordinates Treasury and all the agencies, whether it be transportation or labor, whatever, and also the CEA. It's supposed to coordinate that. But the chairman of the CEA is actually a Presidential appointee above the director of the NEC. So it's a very awkward structure at the moment because you're reporting to someone who is actually beneath you—

01-00:15:28
Sharma: Oh, I see.

01-00:15:29
Holtz-Eaton: —and it's the same with Treasury. So it leads to all sorts of internal confusion.

01-00:15:33
Sharma: But Treasury is actually beneath CEA?

01-00:15:36
Holtz-Eaton: No, no. The Treasury's beneath the NEC, as well. Supposedly—

01-00:15:38
Sharma: Oh, I see. Right, right, right.

01-00:15:39
Holtz-Eaton: —it imports through the NEC but that's the Secretary of the Treasury. So like the Treasury, which goes off and does a lot of its own stuff, the CEA still has the power to go off and do a lot of what it wants to. That's sort of observation number one. Observation number two is the power of the CEA is strictly determined by the relationship between the President and the chairman. If that's a relationship of value and trust, the CEA can be very powerful. And if you're somebody the White House doesn't really know or care about it, forget it. And Glenn was extremely capable of influencing the President and the President trusted his opinion. So when we worked on things, people had to pay attention because the President was going to pay attention to Glenn. And I learned that in '89, '90, as well.

01-00:16:25
Sharma: Right. What were the main issues then that were facing you or the CEA and the Bush administration in those early years?

01-00:16:31
Holtz-Eaton:

I can't even possibly remember. We started out. Tax cut went through, education reform, No Child Left Behind. We worked a lot on international issues. For reasons that would not appear obvious we became the point person for the administration on the Argentine debt restructuring, advice to the Japanese on how to restructure their capital markets. This is one part Glenn's aggression. We're going to work on everything. We fought the steel tariffs like mad. I almost lost my life over that, we worked so hard on that. And I wore out staffers and then the budget was a big deal because going into the summer of 2001, the goal was to have the on budget versus the Social Security [budget]. Right? They were sort of paying attention to that. They wanted the on budget surplus to remain. Things were getting worse. And we ended up running an on budget surplus of one billion dollars driven by gimmicks of remarkable proportions. Mitch Daniels' active participation in the Social Security accounting gimmick that kept that one billion above the line and then the Social Security surplus was what it was. So that's where we were and that was a big deal because when we first went in and talked to the President about how it was looking, Glenn and Larry Lindsey said, "Mr. President, you know, the economy's weakening. We have a problem. We're probably not going to run a surplus on budget. We're going to run a deficit but it's no big deal because it's the unified thing that matters. Don't worry about it." And he said, "We're not going to run a deficit. If you come in here with a deficit, you're both fired. Go fix it."

01-00:18:19
Sharma: I see.

01-00:18:20
Holtz-Eaton: So anyone who thinks the budget didn't matter doesn't understand that a lot of it's driven by context. It mattered a lot to him. September 11th hits and the budget doesn't matter anymore. Never did again for the rest of the Bush Administration.

01-00:18:34
Sharma: Oh, I see. Okay.

01-00:18:35
Holtz-Eaton: Just before. And in what is going to be one of my eternal discredits when I face the Lord after my demise, it is true that as I fled the building on September 11th I thought, "Well, the bullseye is off my back because they don't care about the budget anymore." [laughter]

01-00:18:52
Sharma: And was this—

01-00:18:52
Holtz-Eaton: And I remember thinking that.

01-00:18:54
Sharma: Okay. And it was a political—because there's a common understanding that it wasn't necessarily the explosion of the debt, the deficit or the debt under the Bush administration. People attribute it to September 11th but not so much in a political sense as in the sense that, well, the economy was already sort of experiencing a slowdown and this sort of—

01-00:19:13
Holtz-Eaton: The mechanics went the wrong way. The slowdown in the economy. Spent more.

01-00:19:16
Sharma: Right. Sort of the big picture stuff.

01-00:19:18
Holtz-Eaton: The tax cuts were already in place. So the mechanics--what are the mechanics, they're the same we always have when we have big deficit problems. Economy goes south, spend too much, taxes have been cut. But the politics completely changed. The thing I remember is the budget came out in February of 2002, so that'd be the fiscal 2003 budget proposals and Glenn took it and dropped it on my desk and he said, "If budget is policy, what is our policy?" He sort of dropped it. He was despondent, I think. And I said, "Our policy is win the war at all costs." That's what that budget was.

01-00:19:56
Sharma: Okay. Right, right. Okay. There are so many questions about the budgetary aspects of the war on terror that I want to get into. But one thing that caught my eye might be just an aside. It was interesting to me that the CEA would be asked to weigh in on No Child Left Behind and certain legislation that—

01-00:20:13
Holtz-Eaton: They didn't ask us. We did it.

01-00:20:15
Sharma: Well, you did it. Okay, I see. So this was the definition of what the CEA's role was, what is an economic issue were open to interpretation.

01-00:20:26
Holtz-Eaton: I believe everything is an economic issue at some level, right.

01-00:20:28
Sharma: Sure.

01-00:20:29
Holtz-Eaton: Education is, as we are now really understanding, an enormously important economic policy and our international competitiveness is driven by our skills.

01-00:20:37
Sharma: Right.

01-00:20:37
Holtz-Eaton: A decade ago, that's the same point we were making. And that we had to do much better.

01-00:20:44
Sharma: For instance, a report that you did, you would analyze the sort of—for lack of a better word, the stimulative effects of educational reform.

01-00:20:56
Holtz-Eaton: Or you could look at, as we did, what are international test scores, what's spending per pupil? Because we're not getting our money's worth. We're spending twice as much, inflation-adjusted, as we did twenty years ago and achievement hasn't changed. What's up?

01-00:21:10
Sharma: Yeah, yeah. It's a tragedy.

01-00:21:12
Holtz-Eaton: So the same points you're making then.

01-00:21:14
Sharma: Okay. From an organizational perspective, how would that report make its way through the White House?

01-00:21:20
Holtz-Eaton: So there's Domestic Policy Council and it had the education portfolio and Margaret Spellings was head of the DPC and the DPC would be coordinating efforts to develop not just No Child Left Behind but the implementation, how we're going to do it and we'd send our people in the meetings. We'd send Kate Baker, who was from Harvard, and a good health and education person. Kate went to all the meetings and if she came out of the meeting saying, "They're planning to do X, Y or Z, this sounded really stupid," we'd write a memo saying, "Bad idea. This is why we disagree. CEA wants to be on—"and that's part of the process. That goes on all the time. There are millions of meetings on millions of topics. I did cybersecurity. We did federalism issues. Federalism. Every president puts out a federalism executive order. The Bush administration was no different. Kate Baker reproved the Pythagorean Theorem while suffering through the drafting. That's what you do. [laughter]

01-00:22:22
Sharma: And federalism being a question of how much grant and aid to states, that kind of thing?

01-00:22:27
Holtz-Eaton: And what powers are left there and do you consult with them or do you run over their authorities. One of the Bush administration's hilarious moments was we drafted a new executive order on federalism which basically said, "You should ask a state, be nice, before you do something." They didn't say "Don't do it", they just said, "If you're going to run over a state, you should ask first or at least maybe warn them." And they wanted to roll it out at the

National Governor's Association Meeting but the NGA said no because they hadn't been asked first. [laughter]

01-00:22:55
Sharma: Irony of ironies. That's great.

01-00:21:59
Holtz-Eaton: That's what you do at the CEA.

01-00:23:00
Sharma: Yeah, okay.

01-00:23:01
Holtz-Eaton: You do all these things that you never, ever, ever thought you'd work on.

01-00:23:06
Sharma: It seems like a fascinating place to be and the question is does the advice get listened to or is there advice—

01-00:23:12
Holtz-Eaton: Not always. We lost on steel tariffs, period. Just flat out lost. Worked like crazy. We did a lot of post-9/11 work on the airlines. We were against just throwing the money at the airlines, wasn't going to change anything. The money went out anyway. You lose a lot. It's hard for the staff because they work very hard and then on pure policy grounds they get trumped all the time. And I just say, "Look, if you bat a hundred as an economist in DC you go to the Hall of Fame. You should expect to lose. There are a lot of competing viewpoints."

01-00:23:43
Sharma: I see. Okay.

01-00:23:44
Holtz-Eaton: It's fact.

01-00:23:46
Sharma: It seems as if the big issue already during the 2000 Presidential campaign was what to do with the budget surplus, right, and so there was Al Gore's famous lockbox proposal and then George W. Bush's desire to return the stimulus to the taxpayers or to deal with it through tax cuts. How did you think about this issue? I'm already forgetting what John McCain's position was during the primary but—

01-00:24:16
Holtz-Eaton: We didn't think about it very well. McCain, to his credit—I had nothing to do with this but if you look back at the speeches he gave in New Hampshire, he kept saying, "Be careful. We get these budget projections all the time. This might not be real." That was actually prescient. [laughter]

01-00:24:30
Sharma: Yeah. Sort of—yeah. Don't go one way or the other, wide swings.

01-00:24:35
Holtz-Eaton: Right.

01-00:24:37
Sharma: So when you got into the administration, were there debates within the—

01-00:24:41
Holtz-Eaton: Yes.

01-00:24:40
Sharma: —CEA and within the administration in general over—

01-00:24:44
Holtz-Eaton: There was no big debate over 2001.

01-00:24:47
Sharma: Oh, okay.

01-00:24:48
Holtz-Eaton: That was a campaign promise. Taxes as a fraction of GDP had gotten to 20 percent, which is above the historic norms and I don't think anyone was deeply uncomfortable with the 2001, per se, doing it. What we did with it, the quality of the tax policy I thought was terrible. Such is life.

01-00:25:07
Sharma: In what respect, if you're willing to speak about it?

01-00:25:09
Holtz-Eaton: Thousands of odds and ends, checks that got sent out, the ten percent bracket, which was just taking more people off the rolls.

01-00:25:18
Sharma: I see.

01-00:25:20
Holtz-Eaton: What those things did is make tax reform harder and harder and harder because you've just concentrated the tax on a few upper-income people. The Bush administration just played right into that. And so for someone who cares about tax policy in a broad-based revenue raiser, that was yet another step to turning the income tax into a high-end surtax. That's all it is now.

01-00:25:45
Sharma: I'm a little confused. Can you walk me through this a little more explicitly?

01-00:25:47
Holtz-Eaton: Yeah. So your grandfather's income tax was a broad-based tax. It was a core part of the revenue and in 1982 the single most important thing Ronald Reagan did is he indexed the income tax for inflation. Most important thing he did, period. Now, for years, the way they had done part of the fine tuning and also the politics of it was they had taken the inflation tax and given it back to people. So inflation would push people into higher tax brackets. They would

have a "tax cut" and basically change the brackets so that taxes were in real terms right back to where they were before. Both parties had gotten on this. This was a very popular thing to do and they could cut taxes for people all the time. Once you index it, that game's over because inflation by and large is not pushing people into higher brackets. But they still wanted to give tax cuts all the time and they did. Both parties had learned this lesson. If you look at eighties, nineties, people are getting tax cuts and the way tax cuts always took place is we take these people off the rolls. And so you're just chopping away at the bottom and you're eating away at the base of people who pay the income tax. Now, you might also be trying to keep rates down at the top because that's good tax policy but we just continually took people off rolls. The '86 Act put the EITC more firmly into place. Early '90s we expanded it. More child credits, refundable credits. All these things basically turned the tax code into a narrower and narrower base.

01-00:27:17
Sharma: Oh, I see.

01-00:27:18
Holtz-Eaton: And it's made a mess of it.

01-00:27:19
Sharma: So proposals that were intended as sort of progressive to help the lowest income groups end up sort of pushing the tax burden on middle and upper classes more because—

01-00:27:28
Holtz-Eaton: Sure. Because if you just keep taking people off the rolls at the bottom, you never put them back on.

01-00:27:30
Sharma: Okay, right.

01-00:27:32
Holtz-Eaton: And then if you're going to do tax reform, which is all about broadening the base and lowering rates, you're doing it on a smaller and smaller piece of the population.

01-00:27:40
Sharma: Okay. Interesting.

01-00:27:41
Holtz-Eaton: I think it's a mistake to talk about the income tax the way we talk about it. It's a high-end surtax. This is a tax that a very few Americans pay really.

01-00:27:54
Sharma: Well, the payroll tax has sort of surpassed the income tax.

01-00:27:57
Holtz-Eaton: Yes, it has. It is the biggest tax for the most Americans.

01-00:27:59
Sharma: Yeah. Another interesting thing about the 2001 tax cuts is the fact that they were sort of slow moving. I'm not getting the right phrase.

01-00:28:09
Holtz-Eaton: Phased in.

01-00:28:10
Sharma: They were phased in over a long period of time. This was accelerated in 2003, of course.

01-00:28:14
Holtz-Eaton: And that was the big debate. So the big debate in the Bush Administration was not 2001. That was largely done. But over whether we should do anything at all in 2003. And I would not have done anything. I would have been in the camp that said no. Economies recover. No more stimulus. Now we're back here doing the same stuff again. But what was done in 2003, the cutting taxes on dividends, the accelerated lowering of the marginal tax rates and the investment stuff, is all way better tax policy in my view. So I'd have rather flipped them. I'd have done in 2001 what we did in 2003 and I'd have done nothing in 2003. Alas. [laughter]

01-00:28:53
Sharma: My understanding of why they were phased in in 2001 was to deal with PAYGO requirements. Is this something—

01-00:28:59
Holtz-Eaton: Yeah. They were still in the books.

01-00:29:00
Sharma: So the argument doing it more slowly would be more budgetarily responsible in other words.

01-00:29:05
Holtz-Eaton: Yes, yes. Absolutely.

01-00:29:07
Sharma: And so you think that was a--

01-00:29:07
Holtz-Eaton: And by 2003 those things had expired. And they didn't temper the debate at all.

01-00:29:15
Sharma: I see, I see.

01-00:29:15
Holtz-Eaton: And remember, the surplus is gone, too. So the fantasy that you're somehow being the curator of the 5.6 trillion, that's long gone.

01-00:29:22
Sharma: Right, okay. And the argument becomes much more about stimulating the economy at that point.

01-00:29:26
Holtz-Eaton: Yes. And we've had a jobless recovery, the first of many that we are going to hear about.

01-00:29:31
Sharma: I know you said there weren't many debates about the 2001 tax cut but can you take me back to your involvement, if at all you were involved in that.

01-00:29:40
Holtz-Eaton: Not much. I arrive—remember, I'm first not in, then I'm in later.

01-00:29:43
Sharma: Okay, so it's already—

01-00:29:44
Holtz-Eaton: And so by the time I show up, I'm an academic. I've got to finish the spring semester.

01-00:29:48
Sharma: They were passed in May already.

01-00:29:51
Holtz-Eaton: Yeah. So this ship was sailed.

01-00:29:52
Sharma: Okay.

01-00:29:54
Holtz-Eaton: I'd been flying down consulting. But not a big deal.

01-00:29:59
Sharma: When you got to the CEA, were there people concerned about the long-term budget balance? Were there people who are averse to the tax cuts?

01-00:30:08
Holtz-Eaton: No.

01-00:30:11
Sharma: Okay. Did anyone anticipate or think that they had gone too far in the sense that, well, you would have to—

01-00:30:17
Holtz-Eaton: No, no.

01-00:30:19
Sharma: Okay.

01-00:30:19
Holtz-Eaton: That was just not on anyone's radar. This was about getting taxes to 18 percent of GDP. We know there's a spending problem that has to be dealt with but that's not on the radar.

01-00:30:32
Sharma: And what about the spending side in those first years? What were the proposals, if there were any?

01-00:30:37
Holtz-Eaton: None. None.

01-00:30:38
Sharma: Do you think that was a failure of the Bush administration?

01-00:30:41
Holtz-Eaton: Yeah. Their spending record's dismal, I mean, sort of uniformly. And the worst, of course, was the drug bill, which morphed. What was close to home at the CEA because Mark McClellan was a member of the Council of Economic Advisors. So Glenn's chairman. Mark's a member. He's also simultaneously got an appointment at the DPC as a health policy guy. And he's got the dual appointment and he's running around on the Hill negotiating the drug bill. And Mark spends money hand over fist. There's no restraint there. And so he keeps coming back and the price tag keeps going up and Glenn is flipping out and I'm flipping out and so we are at war with ourselves inside the CEA. This is a nightmare. The administration as a whole does not know what to do with this thing and ultimately I've left by the time—

01-00:31:35
Sharma: You were at CBO at this point?

01-00:31:36
Holtz-Eaton: But I was there at the early parts. It started out as—

01-00:31:37
Sharma: Yeah. Oh.

01-00:31:38
Holtz-Eaton: —low income helping hand. Low income helping hand was a Bush proposal in the campaign, so in 2001 there was a version, 2002 there was a version. But it's ramping up and—

01-00:31:47
Sharma: Oh, I didn't realize that morphed into the Medicare Part D.

01-00:31:50
Holtz-Eaton: And that became the drug bill, yeah. It was supposed to be low income helping hand, not every senior gets a check.

01-00:31:54
Sharma: Oh, I see. So can you go into a little bit more detail about how this evolved? So you would—

01-00:31:59
Holtz-Eaton: Mark would go up and negotiate and the Democrats would say, "We need more money." Mark said, "Of course. No problem." And then he'd come back and say, "You know, we have to make this a little bit richer. It's the politics of it. You need to understand that." And we're like, "No, we don't understand that. Don't."

01-00:32:10
Sharma: Okay.

01-00:32:11
Holtz-Eaton: But he did it and ultimately sold the—broadly, not Mark alone. Broadly, the administration bought into the politics and the virtues of this thing, which is just insane.

01-00:32:22
Sharma: Did you ever think the administration would maybe, once the bill got so expensive, sort of reconsider? Was there a sense that they had—

01-00:32:28
Holtz-Eaton: You could only pray.

01-00:32:29
Sharma: —sort of politically promised this and this was going to go through?

01-00:32:32
Holtz-Eaton: It was never obvious it was going to go through. If you remember, the passage in the House was one of the ugliest pieces of political theater. It went on all night. Denny Hastert is wading through the floor—

01-00:32:43
Sharma: Oh, this is right. Yeah.

01-00:32:43
Holtz-Eaton: —grabbing members and hauling them out and talking to them. We have the unseemly arrival of administration officials,. It was hideous. It was terrible. [laughter]

01-00:32:58
Sharma: So when you're at the CEA and this is going on, is there a sense that you feel—

01-00:33:00
Holtz-Eaton: So I'm at CBO by the time that part's going on.

01-00:33:01
Sharma: Yes.

01-00:33:03
Holtz-Eaton: But I'm watching this thinking—

01-00:33:04
Sharma: Because there is sort of—in the process of formulating the bill, you—

01-00:33:08
Holtz-Eaton: I'm watching this and I'm unhappy about it. I'm looking at the economy and we're talking about these tax cuts that I don't think are going to have—they're good tax policy for the long run but that's not the way they're being sold. They're being sold as stimulus and so I'm—and the deficits clearly going to be—it's here and it's going to be a big deal. I'm getting progressively more unhappy with the state of economic policymaking, just flatly

01-00:33:34
Sharma: Okay. Well, I want to come back to these later issues with your time at the CBA. But do you remember anything about the expiration of PAYGO in 2002? Was there any debate about that, whether in the White House or—

01-00:33:46
Holtz-Eaton: Republicans hate PAYGO and so no, there was no debate about it. It was like done, gone. And remember, once the money starts flowing in in the late nineties, all these rules get waived. They violate the PAYGO scorecard and then they go to sixty votes and they just wipe it clean and off they go again. So I'm not a big believer in any of these rules as actually constraining a Congress. You can't constrain a Congress. If a Congress decides to be serious about budgetary matters, things like this can help support that consensus but nothing like that can stop a Congress that wants to spend money or cut taxes. Forget it.

01-00:34:18
Sharma: Okay, okay.

01-00:34:21
Holtz-Eaton: You can't tie the hands of a future Congress. That's a Constitutional imperative and so you can't write a set of rules that will stop them from doing anything.

01-00:34:29
Sharma: Yeah. The last time we were out in DC we had a chance to interview Rudy Penner over at the Urban Institute who was making this same point.

01-00:34:37
Holtz-Eaton: Absolutely.

01-00:34:37
Sharma: Sort of the same point that it's too much emphasis placed on the process when it's really just essentially the politics of it.

01-00:34:42
Holtz-Eaton: It's the politics. You have to decide to do the right thing and if you don't, not going to happen.

01-00:34:47
Sharma: Okay. Well, interesting nonetheless. At least one big issue from the early 2000s. 9/11, you spoke a little bit about how you sort of realized the budgetary impact of 9/11 right away. But did other people have that same sense? How did—

01-00:35:05
Holtz-Eaton: Oh, my God.

01-00:35:04
Sharma: —9/11 change the optics and the politics of budget?

01-00:35:07
Holtz-Eaton: If you talk to the OMB people, they were in shock, right. So post-9/11, the administration decides to send $10 billion, I think it was, to New York. I'm going to get the numbers wrong, I'm sure. But $10 billion. It's unbelievable that you would send $10 billion to New York. It was just stunning.

01-00:35:31
Sharma: That's a lot of money.

01-00:35:32
Holtz-Eaton: It goes up to Congress, they decide twenty. [finger snap] Just like that. Twenty billion dollars to New York City. It was unheard of and at that point I knew that we're in a new world. They're just throwing money everywhere.

01-00:35:48
Sharma: Interesting.

01-00:35:49
Holtz-Eaton: And [George] Pataki had the nerve to ask for seventy and he was going to build railroads outside Schenectady with it. It was just clear that this was being gamed for money.

01-00:36:00
Sharma: And things can snowball in this respect.

01-00:36:01
Holtz-Eaton: And the airlines are going to get ten billion. The steel companies come in and ask for ten billion. "Why you? Go away." [laughter] You may be—

01-00:36:09
Sharma: Besides—

01-00:36:10
Holtz-Eaton: Everybody started asking.

01-00:36:10
Sharma: —sort of the more fiscally conservative people in the White House, who was arguing against this? Was that part of the problem once there was—

01-00:36:16
Holtz-Eaton: It's hard to argue against, right. If you argue the nation has been harmed by an attack that these terrorists launch, how do you say no to anybody?

01-00:36:30
Sharma: That's the problem. Yeah.

01-00:36:31
Holtz-Eaton: They twice put themselves in a position where it was impossible to say no. The second one was when Bush sat in Lafayette Square down there in New Orleans and said, "New Orleans will rise again."

01-00:36:40
Sharma: That's right.

01-00:36:40
Holtz-Eaton: Good grief, he might as well have said the North will refinance the Confederacy. It was Katie bar the door.

01-00:36:46
Sharma: Wow. Yeah. With money we don't have.

01-00:36:48
Holtz-Eaton: They were terrible on budget stuff.

01-00:36:51
Sharma: Yeah.

01-00:36:51
Holtz-Eaton: [laughter]

01-00:36:52
Sharma: And do you think it's something that was particular to the Bush Administration in this period of time where the US was able to basically borrow money cheaply and that makes the decision a little easier or—

01-00:37:05
Holtz-Eaton: It's a complicated tale, right. But there's a misapprehension of where the surpluses came from, to begin with. So basically what happened was we had the dot.com bubble and the dot.com bubble pulled all this revenue into the late nineties that really should have been in 2000. If you look at the trend line, we sort of got back to it by the middle of the Bush administration.

01-00:37:32
Sharma: Oh, I see.

01-00:37:33
Holtz-Eaton: But if you believed, as CBO did—they extrapolated off the top of the bubble. That's how you get the big surplus. But that was never real.

01-00:37:41
Sharma: Okay.

01-00:37:43
Holtz-Eaton: And that was a big mistake. A big mistake. So the bubble confused everybody. There was some genuine spending stringency in the Clinton administration, discretionary caps, PAYGO rules, all that stuff, the things that were the successor to Gramm-Rudman-Hollings and they did constrain what went on. But that's not how we got the surplus. We got the surplus because we had a bubble and we were taxing options and bonuses at the top rate and there were piles of options on the West Coast and piles of bonuses on the East Coast and that was the money. I did the New York State revenue forecasting when I was at Syracuse and it's all driven by Wall Street bonuses and the bonuses were unbelievable.

01-00:38:22
Sharma: Sure.

01-00:38:22
Holtz-Eaton: And out in California it was all options.

01-00:38:23
Sharma: And those were getting taxes at higher rate.

01-00:38:25
Holtz-Eaton: At the highest rate as ordinary income. Bang. And money just poured in. And when the money poured in, two things happened. Number one, people mistakenly extrapolated that as the basic revenue line and that's why it seems safe to cut the taxes. Because even with the cut, the revenue line was going to be very rich. And the second is that the spending discipline disappeared. When the money rolled in, people just gave it up.

01-00:38:48
Sharma: They thought they could just keep spending and expanding?

01-00:38:50
Holtz-Eaton: It will be fine. And so you come in to 2001, 2002, 2003, that era, and suddenly you find that no, the revenue really isn't there. We're wrong. That projection's a bad projection. And people are angry about that. What I remember at CBO—I inherited that forecast. I didn't make that forecast. And I had to defend CBO every day and people were mad and they yelled at me. That's one of the things I loved about CBO, is that you inherit all their sins. The moment you become director they say things like, "You screwed us in '86." I was like, "Honest to God, I was in—" [laughter]

01-00:39:31
Sharma: And it's one of those institutions—

01-00:39:32
Holtz-Eaton: And they're mad. The members are genuinely mad. They're serious.

01-00:39:36
Sharma: And it's one of those institutions that gets flak on the left and the right and it's—

01-00:39:38
Holtz-Eaton: And you get flak from everybody and that's your job. And that was fine but they were really mad about that forecast. So in the administration, as well, same mistakes were made. So you're realizing the money's not there. People start to realize this in 2001, 2002 because it doesn't come right back. Now they realize what's going on. The revenues are way down and they can't not spend because we've had a national emergency, we have to do something about it.

01-00:40:04
Sharma: We have to do it. And so the—

01-00:40:04
Holtz-Eaton: And so you get one part just rationalization and then you get another part which is, "We're already this deep in, we might as well have a drug bill."

01-00:40:16
Sharma: Yeah. There's some psychology of that. Yeah.

01-00:40:16
Holtz-Eaton: And it's sort of weird.

01-00:40:17
Sharma: Yeah, that's true in the—

01-00:40:18
Holtz-Eaton: And then that's sort of how it went.

01-00:40:19
Sharma: That is—yeah.

01-00:40:21
Holtz-Eaton: It's like this latest episode. We're in a terrible, terrible recession, financial crisis. Stimulus bill. Eight hundred, nine hundred, doesn't matter.

01-00:40:26
Sharma: I guess, yeah.

01-00:40:28
Holtz-Eaton: Eight hundred, nine hundred.

01-00:40:28
Sharma: I guess, yeah. There's some psychology about that.

01-00:40:30
Holtz-Eaton: And it gets silly. That's what we went through.

01-00:40:35
Sharma: Okay. That's interesting. So let's move then to your tenure at CBO. How did you end up at the CBO?

01-00:40:40
Holtz-Eaton: I have no idea. I assume it's a clerical error. [laughter]

01-00:40:43
Sharma: Okay. You were on record when you were appointed that this had been your dream job, actually.

01-00:40:48
Holtz-Eaton: Great job. Best job I've ever had.

01-00:40:49
Sharma: Why had it been your dream job and why was it your best job?

01-00:40:52
Holtz-Eaton: So I grew up reading CBO reports and if you want to teach in public finance you need public policy examples. These reports are great for classes. They're beautifully written because there was a lot of time spent on exposition and there are seven full-time editors at CBO and so they're great to use as teaching materials. And I'd known about CBO and I'd interviewed with them. Knew people whose research was there. So I'd always admired the place and they did stuff I cared about and that was fun. I got there because Jim Nussle with the House budget committee, I somehow got on his radar. I don't know how, honestly. And I was asked to interview. I was at the end of my second year at CEA, was planning to go back to Syracuse. I viewed this as sort of the typical two years of leave and then I'll go back and be an academic again. And when they offered me the CBO job, I couldn't say no. It was just too good a job to pass up. And this is an act of personal insanity. I commuted from Syracuse for five years and went broke in the process. Both my kids were in college.

01-00:42:01
Sharma: Wow.

01-00:42:03
Holtz-Eaton: I had to keep two homes. I borrowed every dime I could—

01-00:42:06
Sharma: I see.

01-00:42:08
Holtz-Eaton: —to make it go.

01-00:42:09
Sharma: Wow.

01-00:42:10
Holtz-Eaton: But it was a great job.

01-00:42:11
Sharma: So you were leading the CBO and commuting?

01-00:42:16
Holtz-Eaton: Yes. I went back to Syracuse every weekend.

01-00:42:18
Sharma: Oh, wow. That's ambitious.

01-00:42:21
Holtz-Eaton: But it was a great job. It's the best job I've ever had to this day. And it's a perfect job for me at the time. I could never do it now. So it's one of these interesting sort of ways your career changes. When I did the CBO job, my peer set, the people I wanted to continue to admire me, were academics and researchers. And so I literally didn't care about the politics.

01-00:42:49
Sharma: I see.

01-00:42:50
Holtz-Eaton: I literally didn't care about the members as politicians. Actually, I didn't care about them at all. Don't tell them that. And literally, if they yelled at me I didn't care.

01-00:42:58
Sharma: Yeah.

01-00:42:59
Holtz-Eaton: Like if one of my academic colleagues had said, "You're a worthless scumbag," I'd have been hurt. I didn't care what the member said to me. So I was perfect for the job at that point in my career. I've now gone on and had a political part to my life. I could never do the job right again.

01-00:43:10
Sharma: Yeah, definitely.

01-00:43:11
Holtz-Eaton: And I should never be asked.

01-00:43:12
Sharma: Well, that seems the point of this being a non-partisan institution.

01-00:43:14
Holtz-Eaton: Yeah. It was perfect for me.

01-00:43:18
Sharma: We're still sort of grappling with the actual selection of CBO directors. It sort of seems like a mysterious process. But I guess in this case it was a budget director.

01-00:43:28
Holtz-Eaton: Oh, it's a simple process. Joint appointment of the Speaker of the House and the President Pro Tem of the Senate. The budget committees take the lead. There are search committees for their respective members. That's the simpler thing. And they take turns being the top. It was the House's turn when I was selected and so Nussle was taking the lead. And then he would have to get others to sign off. But Republicans controlled both houses of congress at this point so it goes through more easily. We've seen CBO sit vacant, really, for long stretches of time in divided Congresses.

01-00:44:01
Sharma: And your predecessor was Dan Crippen?

01-00:44:03
Holtz-Eaton: Yes.

01-00:44:03
Sharma: My understanding is that he had a troubled tenure because he wanted to move to dynamic scoring quickly.

01-00:44:10
Holtz-Eaton: He opposed it.

01-00:44:11
Sharma: Oh, he opposed it. I'm sorry.

01-00:44:11
Holtz-Eaton: He opposed it. So the litmus test for selection of CBO director was support dynamic scoring. And so I was brought in, in the eyes of Democrats, with two huge negatives. Number one, I came straight from the White House, so I must just be a political hack. I was the first CBO director to do that. Number two, I was going to support dynamic scoring. Now, I had been around this dynamic scoring debate since '89, '90 when I was first in Washington and this was viewed by some Republicans as the magic elixir to solve all budgetary woes and my feeling was of course it makes sense to look at the world without the policy, look at the world with the policy and compare all the differences. And that includes feedbacks from the economy and that's dynamic scoring. There is simply no way on principle to oppose dynamic scoring. It is the right way to do policy analysis. Now, executing it in a rigorous fashion is hard. There are a lot of things we don't know that much about and we ought to be honest about that. And then the second is that there aren't many things that really change the path of big economies quickly. And so if you're at all numerate you start to think, "Well, what's the fuss about here?" But they're not numerate in the Congress uniformly. So my solution to this was they want the forbidden fruit, have an apple and beware. And rather than play keep away, which is what

Dan did, and they hated him for it, I gave it to him. And I was sure they'd be disappointed and they were really disappointed. [laughter]

01-00:45:39
Sharma: Yeah, because there's an expectation that it would—

01-00:45:42
Holtz-Eaton: It would solve all their problems.

01-00:45:43
Sharma: Right. But they weren't thinking of dynamic scoring in the most dynamic terms, I guess.

01-00:45:48
Holtz-Eaton: Well, and they liked to cherry pick, right. So the key is that to really do it you have to have a full set of policies. So it's easiest to do with the President's budget, which really is a fully articulated set of policies. This is what I want to do. So here's what we're doing. Here's what I want to do. So we dynamically scored the 2003 President's budget proposals that were the 2003 tax cuts and also the drug bill was in there. So I thought when I gave them this big nothing, right, it netted to be very tiny, that they would correctly draw the conclusion that you could overwhelm good tax policy by spending too much. That's what Republicans should have concluded. What they concluded, instead, was I did it wrong. [laughter] Oh, well.

01-00:46:29
Sharma: Were there—

01-00:46:30
Holtz-Eaton: ----life goes on.

01-00:46:32
Sharma: Can I ask you to describe a little bit in a little more depth about the move to dynamic scoring? I know it took a number of—

01-00:46:38
Holtz-Eaton: You have no idea.

01-00:46:38
Sharma: —staffers to work on this for a while.

01-00:46:42
Holtz-Eaton: This is how this happened. Dan Crippen has laid his body down and said, "We can't do this." They have memo after memo at CBO on implementation. Sort of what do you assume about monetary policy when you do this. If the budget doesn't add up, at some point you have to bring it into balance. What do you assume about how that happens? Do you raise taxes in the out years? Do you cut spending? There are lots of assumptions you have to make.

01-00:47:00
Sharma: Right.

01-00:47:01
Holtz-Eaton: Right. And so my answer to all of this was, "Look, scoring per se is an artificial world. Don't confuse this with economic forecasting or economic science." The analogy is always the football game. Touchdown is six, kick the extra point you get one. Run it across, you get two. Why? I have no idea. And it doesn't matter because as long as you score the same for every game you can compare games across decades. You can compare—

01-00:47:28
Sharma: Oh, I see.

01-00:47:29
Holtz-Eaton: —games across locations. It's scoring and the point of scoring is to be able to compare bills. This bill costs more than this bill.

01-00:47:37
Sharma: Gotcha. Okay.

01-00:47:38
Holtz-Eaton: Whether you've got them exactly right, who knows? You try to be as close as possible. But the comparability is what's at stake. So you have to simply have some rules for dynamic scoring so that there's comparability and we will find a way to do that. Now, the staff is like, "No, this can't be done. Crippen, we ran this off." They didn't want to do it. It's hard work. And so I convened the relevant folks in a big conference room at CBO and I said, "We're going to do dynamic scoring." And they launched into, "No, we're not. No, we're not. No, we're not." I said, "Let me explain this to you." It is going to go up to the Hill and if I have to write in every number personally, I will. Or you can do the work. Which way is this going to happen?" And that scared them to death because I am just crazy enough and knowledgeable enough to fill in a page. So they did it and they did a very good job. [laughter]

01-00:48:27
Sharma: Okay. And their opposition—

01-00:48:28
Holtz-Eaton: But that's what it took.

01-00:48:29
Sharma: —to it was that this was just too difficult of a process to—?

01-00:48:35
Holtz-Eaton: Their opposition is part of a larger CBO phenomenon, which is that they're extremely risk averse. Remember, their sister agency, the Office of Technology Assessment, comparable age, thirty years, is gone. So it was in their memory not unprecedented to have things—

01-00:48:52
Sharma: I see.

01-00:48:53
Holtz-Eaton: So you wanted to try to stay out of controversial stuff. That was bad. Now, my view was it was our job. So this was the division between me and my staff, which we ultimately reconciled. They would rather be two years late and exactly right and I would rather be 90 percent right and on time.

01-00:49:09
Sharma: I see.

01-00:49:11
Holtz-Eaton: Because this is riskier but that's our job. That's our client. We need to inform them to the best of our ability, and that includes being wrong sometime. Remember, they've just blown the $5.6 trillion surplus. They're a terribly risk averse crowd and dynamic scoring was just another example of that. We're not going to go do that.

01-00:49:29
Sharma: But was there a sense on the staff's part, because it would seem as if they didn't move to this when there was the sort of political demand for it, that it would denigrate the institution. So this is a way to keep the institution—

01-00:49:37
Holtz-Eaton: I thought its store had already fallen enough. When I arrived at CBO, I thought it needed to be refurbished in its public image. During Crippen's time its baseline had been discarded by the budget communities. They'd use the OMB work instead.

01-00:49:54
Sharma: Okay. Which was a huge historical shift.

01-00:49:56
Holtz-Eaton: Which I just thought was appalling. And I just said that's never going to happen on my watch. We are the Congress's budgetary entity. They're not going to use OMB's. And so I was working very hard to make sure that we were thinking ahead to what the client would need. So in 2004, with the elections coming, we built full scale Social Security analysis in case Bush won, full scale health analysis in case Kerry won because we knew it was going to go that way. CBO had never done this before. Had never gone out and actively prepped for what the next Congress might do and I wanted to do that so we would be on time. They couldn't complain about service. They might disagree with the substance, and that was my job. I would defend them. The deal I cut was we will never be late.

01-00:50:39
Sharma: I see.

01-00:50:40
Holtz-Eaton: That's intolerable. And if they're unhappy, it's my problem. I will defend the staff everywhere and always. And I did.

01-00:50:46
Sharma: You were very aware of the need to rebuild this as an institution and its relevance.

01-00:50:51
Holtz-Eaton: Absolutely. The institution needed to be rebuilt.

01-00:50:53
Sharma: I see. And was this—I don't want to go too far down this road, but the lack of credibility in the CBO based primarily on its missed projections of the surplus?

01-00:51:08
Holtz-Eaton: That was the top line thing that everyone knew but it's the member level things that gets you the biggest trouble and the biggest fights. It's not the $400 billion drug bill. It's the fifteen million you claim something cost when they told a constituent it would be five. And being late with those kinds of little things, or not explaining them clearly, bad communications, hurt CBO more than anything. And so we did all that stuff.

01-00:51:32
Sharma: Or more than being late. Being too realistic about the cost maybe is—

01-00:51:37
Holtz-Eaton: Right. They needed to remember that CBO is independent and that's true and it's important, but they work for the Congress. Those are both true simultaneously. [laughter] And so I just kept saying, "Look, we are Congress's think tank. That's our client. We have to anticipate our client's needs. We have to give them something in a digestible fashion that they can use or they're going to be unhappy." And I still screwed up. Everyone makes mistakes. We wrote a really unflattering letter on a trade policy. We were all sort of basically free traders at heart and we wrote something that was an undisguised free trade manifesto, largely because we rushed it and we didn't have the editors look at it and it just was not balanced in the usual CBO fashion. I was in Senator Byrd's office inside fifteen minutes of its issuance and he asked me if I wanted to run CBO on a dollar a year.

01-00:52:28
Sharma: I see.

01-00:52:31
Holtz-Eaton: So I remembered we worked for Congress. [laughter]

01-00:52:33
Sharma: This is something that we, in our interviews with previous CBO directors, have heard the same sort of story.

01-00:52:38
Holtz-Eaton: Absolutely.

01-00:52:39
Sharma: That there's this tremendous political pressure coming from both sides. And so did you take that as a legitimate concern or did you think that CBO was entrenched enough as a—

01-00:52:49
Holtz-Eaton: I didn't think he'd actually cut our budget to a buck, but the message was received. Number one, my rules of operation were simple. If you're going to whack someone who's not a free trader upside the head, warn them first. Never surprise them in public. And we'd given people no heads up this thing was coming out. It was a provision he cared about. It was a Byrd rule for anti-dumping.

01-00:53:15
Sharma: I see. I see. Okay.

01-00:53:16
Holtz-Eaton: And so my bad. We had done the wrong things in terms of client service. We hadn't warned them. If your client's going to get bad news and you can warn them, you should.

01-00:53:26
Sharma: Oh, okay. I see.

01-00:53:28
Holtz-Eaton: Doesn't change the news.

01-00:53:28
Sharma: And you would do that normally.

01-00:53:28
Holtz-Eaton: Sure.

01-00:53:29
Sharma: You'd call up specific representatives or whatnot.

01-00:52:33
Holtz-Eaton: Yeah. Committees of jurisdiction. I would say, "We're putting out a letter on countervailing duty and subsidy offsets," right. I make that call to the Byrd office. They know where it's going to end up and so they're ready. And then they can have their press release saying the CBO's always been stupid ready and that's all they want.

01-00:53:55
Sharma: It's the optics of it. Okay.

01-00:53:55
Holtz-Eaton: It was fine. And I just ignore stuff like that. They're going to do that, fine.

01-00:53:59
Sharma: And you knew that was going to be your role as the CBO director. That's sort of part of the office.

01-00:54:03
Holtz-Eaton: Yeah. You serve a bunch of different functions but part of what you serve—CBO serves this sort of psychosocial role as—it's like kicking the dog. You're there to allow the members to vent. They get to blame you and scream and they're just frustrated. That's fine. Be that way.

01-00:54:22
Meeker: Five minutes.

01-00:54:24
Sharma: Okay. Well, I'll ask one more question and then we'll just switch the tape.

01-00:54:26
Holtz-Eaton: Yeah.

01-00:54:28
Sharma: What were your relations like with the Office of Management and Budget during your time at CBO? Did you have any sort of working relationship or do these institutions run sort of in parallel?

01-00:54:37
Holtz-Eaton: Washington is characterized by vast staff level conspiracies and so they all talk to each other. And the staffs at CBO and OMB talk continuously, largely to make sure that they don't blindside each other, get in fights at a senior level that are avoidable because people know it's coming. Same kind of heads up I'm going to Congress they're giving to OMB. CBO has to do the analysis of the President's budget every year, so they want to understand things. They're talking to the staff over at OMB saying, "When you had this proposal, how exactly did you think it would work? Tell us." So that is fine. Top level there's not much that was discussed. I had good relations with Mitch Daniels. We didn't talk much but when we did talk—with Josh Bolton. He had been deputy chief of staff for policy and so I'd known him. Again, so I knew those guys but it wasn't a big deal.

01-00:55:34
Sharma: Okay. Well, I want to get into a little bit more substantive questions about—

01-00:55:39
Holtz-Eaton: I do want to say this about Bush. This is one thing. Bush gets all sorts of blame but he gets credit in some places. So I went to CBO like February of 2003, February 4th or something, 5th or something. I know this because February 3rd is my birthday and it was shortly thereafter that.

01-00:55:54
Sharma: February 5th is your birthday?

01-00:55:56
Holtz-Eaton: Third.

01-00:55:56
Sharma: Third, I'm sorry.

01-00:55:56
Holtz-Eaton: So I actually thought my appointment was going to be on my birthday but it took a couple more days. I went back to the White House only once and I was nervous about doing it because the economic report of the President comes out and I had prepared that economic report of the President with the staff and they were going to going to get their pictures taken with the President and stuff like that. And so I went back for that session to see the staff and to be with them for that even though I'd been to CBO. And so I was very nervous about this. I kept it completely under the radar. Didn't make a big deal out of it at all. And Bush was nice. Pulled me aside and he said, "Congratulations on your new job," and he said, "Here's the thing." Obviously he had heard about all the flak I was getting because I'd come straight from the White House as a partisan hack. He goes, "You go down there and you call them the way you see them. I'll be fine on average. Don't you worry about all this stuff. Just call them the way you see them and you'll be fine and so will the Republicans." That's all he said. I thought it was great advice. [laughter]

01-00:56:47
Sharma: And you took it. But I want to get in, because I think there's an interesting history here I think during your tenure at CBO and maybe you can correct me on some of the mistakes I'm going to make. But it seems as if there was a consistency during your tenure at CBO where you or the office would at least—you would give realistic assessments of some of the legislative proposals. Some of the Bush administration proposals.

01-00:57:14
Holtz-Eaton: Yup.

01-00:57:15
Sharma: But they would go through anyway. It didn't really seem to make a difference sort of, whether it was the prescription drug bill, the 2003 tax cut. I think the Katrina spending. And it raises an interesting question in my mind about CBO's ability to actually serve as a disciplinarian or as a gatekeeper.

01-00:57:38
Holtz-Eaton: It's not a disciplinarian. It's none of those things. I know you have to change the tape. We'll come back to that.

01-00:57:44
Sharma: Okay.

01-00:57:44
Holtz-Eaton: The CBO has a very funny role.

[End Audio File 1]

Begin Audio File 2 02-07-2011.mp3

02-00:00:21
Sharma: Okay. This is Patrick Sharma again with Douglas Holtz-Eaton on February 7, 2011, tape two. So we were talking a little bit about your tenure as CBO director and this sort of—I think an interesting phenomenon where the CBO during your watch was providing realistic assessments of legislative proposals, often which ran against what the White House wanted. And I'm thinking of the prescription drug bill or the 2003 tax cut. There's a strand in the literature on the CBO that says that the CBO has real power to kill legislation if it judges it negatively. That says it'll have an adverse effect on the budget. Nevertheless, all these proposals seem to have gone through. Can you speak a little bit about what you saw the role of CBO? Not as a disciplinarian but as something else, I guess.

02-00:01:13
Holtz-Eaton: Right. So here's my view of CBO, which is that CBO is a miracle and that no one could have designed things voluntarily the way they did it. Just is an accident that it turned out to be configured exactly right. And here's why. The '74 Budget Act, which created the budget process in the CBO, creates as part of this the budget committees. So they are literally the new guys on the block, and the appropriators, who have been around since God invented the United States, have no interest in letting them have any power. And they have no power, all right. So they're trying to make sure this gets kept under wraps. They don't like this whole budget idea. Nevertheless, the budget committees have the official power to score everything. They're the ones who actually put out the official numbers on what everything costs. CBO technically is nothing but advisory to the budget committees. It's just one big advice body. It has no statutory authority whatsoever. So now you're the powerless budget committees. How do you acquire power? You do it by building up the CBO. On a bipartisan basis, they have both provided CBO with resources. It's got a good staff of very qualified people, and by touting them as the world's greatest experts. We couldn't possibly disagree with CBO. They're experts. And on a bipartisan basis they're always right. So they have built their power internally by basically conspiring to make CBO into a god. And it's just the dynamics. That's how the political dynamics have worked and it worked beautifully. And if you understand that, in my view, if you're a CBO director and you understand that what you need to do is to get CBO into that advisory role, that means that you are serious about being timely. As I said, you've got to give people advice when they need it and if you're late you don't look like a god if you miss the boat. You have to explain your reasoning. You have to go up and—so that the budget committees can then turn around and explain how CBO arrived at this conclusion.

02-00:03:25
Sharma: I see. All right.

02-00:03:26
Holtz-Eaton: So they might have disagreed with our conclusions but they always understood how we got there. And I was a college professor. I liked explaining things, so it's fine. So I would go up and I would—and we spent a lot of time explaining things. And so I played the role into what I perceived to be the way the political dynamics were. We were the smart outside guys. Don't pretend to know politics, don't play politics, don't engage in politics, be above the politics. And that's what I did as best we could.

02-00:03:54
Sharma: And so whatever would happen would happen with this as far as passage?

02-00:03:57
Holtz-Eaton: And they would yell at me sometimes. Yeah. There were unpleasant moments. [laughter]

02-00:04:01
Sharma: So how do you account? Because there's certain instances in recent history where it seems as if the CBO did have sort of a real decisive impact, for instance, with Bill Clinton's effort to reform health care.

02-00:04:13
Holtz-Eaton: He didn't have the votes. And the Republicans didn't want it to be big government. If they could make the case it was big government, they could kill it. And the CBO did, in fact, rule that what were key elements of this were governmental entities. That killed it. It wasn't anything else. The Republicans killed it.

02-00:04:33
Sharma: Okay.

02-00:04:34
Holtz-Eaton: So it's the same as budget rules. The CBO can't stop anything that Congress really wants to do. [laughter] You can tell them anything and they'll just go ahead.

02-00:04:43
Sharma: Yeah. It's more sort of symptomatic of other forces at work. But with the move to dynamic scoring, there was this, as you mentioned just previously, disappointment, at least on the Republican side, that it didn't produce the—

02-00:05:01
Holtz-Eaton: Magic solution.

02-00:05:01
Sharma: —I guess magic solution to tax cutting. Were you surprised by that?

02-00:05:08
Holtz-Eaton: Oh, no. I knew both what I was getting into, because I'd done macroeconomic modeling. It's very difficult to change the growth rate in the US economy. Right. I've been in two CEAs and every CEA puts out a report that says that

the President's preferred policy, whatever it might be, is going to change the average growth rate over the next ten years by .2 to .3 percentage points a year. You can go back and find it. Ours was on taxes. The Obama administration claimed healthcare reform would do it.

02-00:05:40
Sharma: Yeah.

02-00:05:41
Holtz-Eaton: All CEAs put out such things. But the important thing is that it's always two-tenths to three-tenths.

02-00:05:46
Sharma: Not significant, yeah.

02-00:05:47
Holtz-Eaton: You just can't move the growth rate very much. And people know who know economics know that those are actually big moves. The growth rate of per capita income between the United States and United Kingdom differed by .3 percentage points between 1776 and now. And in the process we became the world's largest, most dominant economy and they became a glorified third world nation. Little differences—

02-00:06:11
Sharma: Yeah. Well—

02-00:06:12
Holtz-Eaton: —matter enormously. I apologize. [laughter] But, I mean, they matter enormously. So if you do this stuff and you know those little growth rates are worth, as a matter of policy, going for them and you're going to try to get that, that's worth it. But if you're on the Hill and you change the growth rate from 4.1 to 4.4 in nominal terms and then you tax it, you don't get much, right.

02-00:06:34
Sharma: Right. No one's going to feel it.

02-00:06:35
Holtz-Eaton: So it was never a surprise. [laughter]

02-00:06:36
Sharma: I see, okay. Yeah, no one's going to feel it in that sense. So how would you say, besides dynamic scoring, the CBO changed under your watch?

02-00:06:45
Holtz-Eaton: Oh, I thought we were more proactive, responsive. We engaged in a lot more things. I wanted us visible and so I never turned down the testimony. They used to say, "No, we don't feel like testifying." I thought they should hear from us. We're their people. And so it didn't matter what it was. I testified on troop rotation strategies in Iraq, about which I am a world class expert, I assure you. What do I know about that? Nothing. But we have a national

security division. We testified. We did studies on everything under the sun. What does it cost to go to the moon and then Mars. Alternatives for amphibious forced landing. You name it, we studied it. And we did a couple of notable things, depending on the eye of the beholder, that got us a lot of attention. Whether it was all the work on the drug bill, which was a big deal, all the work on dynamic scoring, which was a big deal, the Boeing tanker deal, which was a bad but important deal where CBO analyzed extensively the budgetary arrangements and the financing scheme and it had its own corruption aspects about which people ultimately went to jail. But budgetarily it was also a terrible deal for the taxpayer and had Enron-like financing structures that were just—and we put together these charts and we briefed people on how bad it was. It is the place where I made my name inside CBO and also changed my career. Literally. John McCain had me up to testify on the Boeing thing. CBO has a couple of things. Statutorily you are barred from making policy recommendations. So you're not allowed to do that and so I always took that very seriously, not because I was a Republican but because I'm an economist. I was sure I knew everything and I would have to bite my tongue. But he got me up there and I'm on a panel with three other sort of GAO types, Congressional research service types.

02-00:08:43
Sharma: Yeah. I see.

02-00:08:44
Holtz-Eaton: And he just says, in classic McCain fashion—he's not going to let you off. He says, "I'm going down the line here. Given what you know about this deal, yes or no? Should we do this?" I forget how he said it. GAO guy is, "Well, I can't make a recommendation, blah, bleh, bleh." CRS guy, "Reh, reh, reh." Gets to me and I said, "No."

02-00:09:03
Sharma: And this was a big—

02-00:09:03
Holtz-Eaton: And I heard the whole staff behind me gasp. Just like, "Gasp." And McCain said, "Thank you. About time we got a straight answer from somebody." And that's what got me on that 2008 campaign. [laughter]

02-00:09:17
Sharma: Oh, really. Oh, okay.

02-00:09:18
Holtz-Eaton: That's how that happened, from his point of view. He remembered I was someone who would shoot straight. And my staff walked out and I said, "I know you guys are unhappy." And they said, "No, we've never been prouder."

02-00:09:28
Sharma: Oh, wow. Okay. So you think that's sort of an antiquated limitation?

02-00:09:30
Holtz-Eaton: And that really helped.

02-00:09:31
Sharma: Or is that something that should be—

02-00:09:32
Holtz-Eaton: No, I thought it wasn't really a policy call. This was just so corrupt. You could just—

02-00:09:36
Sharma: It was so clear.

02-00:09:36
Holtz-Eaton: You had to say, "No, you can't do this."

02-00:09:38
Sharma: Okay. Well, I guess that's how the—

02-00:09:42
Holtz-Eaton: But that meant a lot to them, particularly the national security guys, some of them who had served. And this guy said, "I've been a Marine and I'm just so happy."

02-00:09:50
Sharma: They didn't want to see that boondoggle. What about the prescription drug bill? Maybe if you could take us inside that a little bit, whether at the general or the specific level.

02-00:09:59
Holtz-Eaton: First of all, it's endless. It's been going on in negotiations between the administration and the Congress since 2001. Get to 2003, another round ramping up. The administration sends over a budget that says, "Here's a $400 billion placeholder. Go do prescription drugs. And so it's got to fit into 400 and there's a lot of pressure on us at every iteration on scoring and what's it cost because they want to give drugs to everybody and they want it to cost $400 billion. And in much the same way that this CBO, in my view, has gotten gamed on the health care bill I got gamed on the drug bill. There's some zeroes up front. We're not going to do anything for a year. And then they would carve this provision. They'd do it just sending a proposal. We'd score it. They'd learn a little bit about it. They'd send in another one and we'd score it.

02-00:10:49
Sharma: Oh, I see. So they—

02-00:10:51
Holtz-Eaton: Pretty soon they fine-tuned that legislation. So—

02-00:10:52
Sharma: Oh, okay. So they manipulated the legislation to make it more budgetarily appealing?

02-00:10:57
Holtz-Eaton: Of course. Absolutely.

02-00:10:59
Sharma: Okay. And that is—

02-00:10:59
Holtz-Eaton: And literally, the weekend before it passed, when the conferees are trying to get together between the House and the Senate for one last time, they sent over yet another version of this stuff and I think we scored it at costing $355 billion. And Bill Thomas flips. He goes, “That’s too much money on the table. Jesus Christ. Can’t you guys get anything right?”

02-00:11:23
Sharma: Which is—

02-00:11:24
Holtz-Eaton: He’s just frustrated beyond belief. So they have to fix it again and it comes out at $395 [billion]. [laughter]

02-00:11:30
Sharma: Wow.

02-00:11:32
Holtz-Eaton: Because he knows he can’t take it to the members with—

02-00:11:36
Sharma: Yeah. With over 400.

02-00:11:38
Holtz-Eaton: No, with 350 because then they’re going to want to add some stuff in.

02-00:11:38
Sharma: Yeah.

02-00:11:42
Holtz-Eaton: So they fine tuned it to 395.

02-00:11:45
Sharma: Did you feel constrained at the CBO in dealing with this issue in the sense that you couldn’t just run your own analysis of this and say that it would be much too expensive? The fact that you were responding to specific legislative influence.

02-00:12:02
Holtz-Eaton: You score the legislation as written and that’s part of the deal. And then you pray somebody asks you. Because you can’t make policy recommendations. So you can’t just wander out and say, “Bad idea.” Right. And so you pray

someone asks you the question that allows you to answer and say, "That's not what it really costs." And the Republicans just didn't—they made sure no one asked me. And the Democrats screwed up and didn't ask me.

02-00:12:31
Sharma: I see.

02-00:12:31
Holtz-Eaton: Right. The best example of this is if you remember Doug Elmendorf recently doing this health care debate. Got a lot of acclaim for standing up and saying that the House bill didn't bend the cost curve. He didn't stand up and say it. Conrad asked him. And Kent Conrad convened a budget committee hearing solely for the purpose, I believe, of finally getting Elmendorf up there so he could ask him the question, force Doug to answer the question—

02-00:12:56
Sharma: I see.

02-00:12:56
Holtz-Eaton: —and thereby kill the House bill. And he did. [laughter] Doug got all the credit.

02-00:13:03
Sharma: And this gets the CBO on record.

02-00:13:03
Holtz-Eaton: And I get that.

02-00:13:04
Sharma: Sort of kind of thing.

02-00:13:04
Holtz-Eaton: But it was Conrad wanted the answer and so he made sure he got it. And that's what the CBO does. So in my case, they didn't want the answer. They wanted to pass the bill.

02-00:13:13
Sharma: Oh, I got you. Wow.

02-00:13:16
Holtz-Eaton: I went up to the Heritage Institution the week after the bill passed and I gave a speech and then there was some Q&A and someone asked me the question, "What would this thing cost in the second ten years?" I said, "Two trillion dollars." And I had a phone call from Denny Hastert so fast you couldn't believe it.

02-00:13:28
Sharma: Really?

02-00:13:30
Holtz-Eaton: Oh, yes. "I would be extremely grateful if you never again mention $2 trillion."

02-00:13:37
Sharma: Well, it's small change nowadays but—yeah, yeah.

02-00:13:38
Holtz-Eaton: No, but that's how the place works. It's interesting that way.

02-00:13:40
Sharma: I see. Well, certain strong limitations on what one can do as a CBO director it seems. As much as you can speak out but—

02-00:13:48
Holtz-Eaton: Sure.

02-00:13:50
Sharma: —there still is responding to Congress.

02-00:13:50
Holtz-Eaton: The CBO is a creature of Congress.

02-00:13:51
Sharma: Yeah.

02-00:13:52
Holtz-Eaton: You work for Congress. It's not like now. I work for myself. I can say exactly what I think. That was the greatest thing for me personally was—I spent 2001, 2002, I was the voice of the Bush administration. In public I talked about the Bush administration positions. And then for 2003 to the end of 2005 I had no opinion whatsoever. All right. And then I go on the McCain campaign where I have John McCain's opinion. It's kind of nice to have an opinion again. It's been a while. [laughter]

02-00:14:22
Sharma: This is maybe getting us away from the topic.

02-00:14:25
Holtz-Eaton: Yeah.

02-00:14:26
Sharma: It's hard to switch back and forth in the sense that—inevitably, especially from an academic background—

02-00:14:30
Holtz-Eaton: It wasn't hard for me.

02-00:14:31
Sharma: —you're going to have reservations or at least we're not accustomed to framing things politically.

02-00:14:36
Holtz-Eaton: But a good economist can see supply and demand and economics is all about trade offs, right. And so it never was that hard for me, at least, to try to understand the liberals' position.

02-00:14:51
Sharma: Right. Well, but that doesn't play on a—

02-00:14:52
Holtz-Eaton: And then flip back and understand the conservatives' position and be able to educate people when I'm at CBO about some people think this and this is why and some people think this and this is why. And your choices are this. That wasn't hard for me. And then I know where I stand. And if people ask me that, I can tell them. I didn't find it that hard.

02-00:15:10
Sharma: Well, in a CBO role it would be fine but as a political animal it would be much more difficult because as an academic one sort of hedges and sort of—

02-00:15:20
Holtz-Eaton: Yeah.

02-00:15:21
Sharma: Seeing the trade-off is not necessarily the most valuable political skill.

02-00:15:24
Holtz-Eaton: But I worked very hard at CBO. It's one of the things I did that I don't think my predecessors did. I worked very hard at sound bites. I knew that when I went up to testify I had about thirty seconds to get their attention and then—you've seen members at hearings. They wander off.

02-00:15:39
Sharma: Yeah. They just get out of there. Yeah.

02-00:15:40
Holtz-Eaton: And so you have to realize in the Senate you've got millionaires. You've got very successful people that aren't stupid. Their other jobs are way too busy. So if I thought of myself as a teacher, I'd be like, "I can't give a thirty minute lecture and lose them at the beginning." I have to figure out what I'm going to say in the first thirty seconds. And that served me well down the run.

02-00:15:59
Sharma: I guess the teaching background, that's an interesting aspect. I want to ask you a little bit about the war on terror and the budgetary aspects of that. One of the things that stands out in retrospect, of course, is the funding. Funding so much of the war in Iraq, especially, through supplemental bills.

02-00:16:16
Holtz-Eaton: Yeah.

02-00:16:17
Sharma: Was this something that you were concerned about, expected? How do you place this in context?

02-00:16:21
Holtz-Eaton: I didn't think it was a big deal at first but over time it became progressively less tenable. Good budgeting says that you should put on the budget your best expectation of the resources that are necessary for every task and budgets should be comprehensive in nature for a reason. And the notion that somehow the Bush administration was deliberately not including in their budgetary proposals foreseeable outlays—I didn't want to ask them to commit to 50,000 troop footprint in 2010. That wasn't probably within their capability. But zeroes weren't plausible. So that's just bad budgeting.

02-00:17:01
Sharma: Okay. But there's nothing one can do, let's say, unless you're in the White House.

02-00:17:05
Holtz-Eaton: Right. And so one of the things I invented when I was at CBO, which is now a standard part of their documents, is what I called the build your own baseline table. The official CBO baseline is current law and takes everything at face value and just extrapolates on the current law. But it was clear that current law and current policy weren't the same thing. And so I'm the one who invented the table that said, "Oh, if you think we're going to have this many troops, add. If you think the tax cuts are going to sunset subtract." And we built that for people so that they could fill in those gaps.

02-00:17:42
Sharma: So you get those three trend lines that one could get.

02-00:17:44
Holtz-Eaton: So you could fill in the gaps that the Bush Administration particularly left in the war.

02-00:17:48
Sharma: I see. And that was explicitly because you were----

02-00:17:52
Holtz-Eaton: I wanted the Congress to be able to figure out what was really going on.

02-00:17:54
Sharma: Okay, interesting. Whether that, again, makes any difference is—

02-00:17:58
Holtz-Eaton: And, again, the politics of it. I was not going to commit suicide by running straight at the White House on this. I put out the war and the tax cuts but also put out other things so that there was a menu there and they could build their own baseline.

02-00:18:11
Sharma: Right, right. Another key event in this history is Bush's efforts to privatize Social Security after his reelection in 2004. Can you describe your views on that and what the CBO thought of that?

02-00:18:26
Holtz-Eaton: We were very unpopular on that one. So if you want to put private accounts into Social Security, that's a policy issue. It shouldn't be done for budgetary reasons. That's all there is to it. And there are a variety of arguments associated with it. The key budgetary issue is how you treat the rate of return on equity investments. So we're about to go into the land of geeks. Here's the land of geeks. There's something called the equity premium and the equity premium is the higher expected rate of return on equities relative to, say, treasuries. What does that come from? It comes from the fact that they're riskier so you have to pay people more to take on that risk. So that means that there's a point at which people are indifferent between holding the risky equity or holding the treasury. Now, if you did it in Social Security, what you're really saying is those are equivalent investments so you ought to treat them equivalently on the budget. Put differently, you want to risk adjustment. You want to take that higher rate of return and knock it down for the associated risk, and we did that. Because that's good economics.

02-00:19:43
Sharma: So that would mean that the stock investments—

02-00:19:44
Holtz-Eaton: That makes the rate of return on eq—

02-00:19:46
Sharma: —are not as attractive as they—

02-00:19:48
Holtz-Eaton: They don't look as good on paper as people wanted them to and they were really mad about this. But if you do it any other way you open up the following game. The government has a budget problem. What should it do to solve it? It should borrow a dollar using treasuries, average rate of return, say, two percent. Invest it in equities, average rate of return eight percent. Pocket the difference. So the solution to any budget deficit should be to borrow massively and invest in equities. Well, that makes no sense whatsoever but that's what they wanted us to say about Social Security and I wouldn't say it.

02-00:20:16
Sharma: I see. That's an interesting way to—yeah. Okay.

02-00:20:21
Holtz-Eaton: [laughter] Because it leads to all sorts of nonsense.

02-00:20:22
Sharma: I see. Interesting. And the fact that you're risk adjusting because that's something that many people aren't willing to take that conceptual leap to think that the stock market is a risky—

02-00:20:29
Holtz-Eaton: And I promise you it was one of the worst sales jobs in history.

02-00:20:35
Sharma: From the Bush administration's perspective?

02-00:20:37
Holtz-Eaton: And from mine in trying to explain it to Congress.

02-00:20:38
Sharma: Both. Oh.

02-00:20:39
Holtz-Eaton: Jim Nussle kept saying to me, "Why don't you just do what you did with dynamic scoring. You explained it beautifully and everyone understood it and even though they didn't like what they heard they under—but they were just mad about this. They couldn't get their head around it. And I slowly came to realize that, number one, there was just some financial ignorance out there. They didn't get it. And the second is, especially in the Senate, these guys actually don't believe they'll ever lose. Many of them would tell me. I would tell them about how stocks are risky investments and they'd look square at me and they'd say—

02-00:21:06
Sharma: Well—

02-00:21:07
Holtz-Eaton: —"I've never lost money on a stock." And "I was down ten points with two days left in my race and I won" and they all believed of bending the odds in their favor. And it's just like, "No, sir." Now I think we're over this.

02-00:21:20
Sharma: Certainly—

02-00:21:20
Holtz-Eaton: We have seen vivid examples of financial risk.

02-00:21:23
Sharma: Right.

02-00:21:24
Holtz-Eaton: But at the time, this was not a high water mark for my tenure.

02-00:21:31
Sharma: Certainly, yeah. But no, that psychology's interesting. And then people don't want to actually—even if they do believe that it's a risky investment, there's a right, want to maintain an air of public confidence and all that kind of thing.

02-00:21:43
Holtz-Eaton: Right, right.

02-00:21:43
Sharma: I'll finish my main questions, then we can go over to Martin for some follow-ups.

02-00:21:48
Meeker: Sure.

02-00:21:50
Sharma: But I want to have you think about George W. Bush's fiscal legacy. I know you were just there for the start of his tenure. But you're the first official from his administration that we've had a chance to interview and certainly brings us up into more recent past. But nevertheless, it was, in I think a lot of ways, a real revolutionary presidency fiscally. What do you—

02-00:22:12
Holtz-Eaton: Oh, I think less so. I don't think there's that much of an— I think his main legacy, his main legacy, is that we knew in 2000 that the baby boom was going to turn sixty-five in 2011. That was a knowable fact. And everyone like me who ever studied this problem says these entitlement programs are going to be a big problem. And what we did during the decade, in the eight years particularly of his Presidency, that is most important is that we didn't fix it. It's more the lost opportunity than the active things that people talk about.

02-00:22:52
Sharma: I see. Okay.

02-00:22:53
Holtz-Eaton: People point to the wars and how expensive they are. It's true. But we spent more on the stimulus bill than we did in the entire Iraq War. The prescription drug bill was expensive and I agree and it wasn't paid for. Those are marks that you can make. But the real indictment is not the tax cuts or the drug bills or the wars. It's not fixing problems we knew we had. That's it.

02-00:23:18
Sharma: And so were there specific lost opportunities wherever—any—

02-00:23:22
Holtz-Eaton: Social Security. Social Security.

02-00:23:23
Sharma: Well, I mean, but that was in a—

02-00:23:24
Holtz-Eaton: Don't fight a war over accounts. Fix Social Security.

02-00:23:27
Sharma: And that would have entailed what exactly? Raising payroll taxes or reducing benefits or a combination thereof?

02-00:23:35
Holtz-Eaton: You can do any of those. Social Security's easy to fix on paper. It is all about—seriously. It is all about not doing anything other than slowing the growth of benefits, especially for high lifetime earners. So it's all about me. All you have to do is change the benefit formulas so I get more than retirees get now but less than I've been promised. And it comes into balance relatively easy over long periods. And we had more time. And so that's the great loss. Now we're at the point where I'm fifty-three and I'm the trailing edge of the baby boom generation. And if you don't reform my Social Security and Medicare and Medicaid, you've grandfathered the baby boom, which means you've grandfathered the problem.

02-00:24:16
Sharma: Yeah, yeah.

02-00:24:17
Holtz-Eaton: That's what we lost. Time.

02-00:24:19
Sharma: I see. Okay. I think that's right. The explosion of the debt under Bush is another major facet. We touched on this already and it has to do with sort of this relatively slow growth, declining tax revenues and no effort to restrain spending. And so it seems as if living with the—

02-00:24:41
Holtz-Eaton: But he left with the GDP at 40 percent.

02-00:24:43
Sharma: Well, it improved in the second term.

02-00:24:47
Holtz-Eaton: And they did get some religion in the second term. They didn't spend money as much hand over fist. They did the same games this administration is. Both administrations are playing the same games. It's actually quite frightening. This is what scares me the most, which is both Presidents that we've seen recently have run the following playbook. "Well, when I arrived there was an enormous recession and a big crisis." With Bush it was 9/11, Obama it was the financial crisis. We had to spend money. Lots of money and we know that. And we're going to have big deficits and that's just what happens and we can accommodate it. But we promise we'll cut it in half before we're done. It's exactly the same words. You can look them up. They both utter the same phrases. And so you will see in this administration the same thing you saw in the Bush, which is some stringency, five year freezes on non-security

spending, which is what you're seeing the President talk about now. That'll be real and genuine stringency at the edges. But there's no appetite to fix and that's what makes me nervous.

02-00:25:45
Sharma: No, there's no political—

02-00:25:46
Holtz-Eaton: Same thing.

02-00:25:51
Sharma: Well, I've been dying to ask this question of people and it's something I really don't understand. Well, there's two sides to the story. There's the spending and what the government is doing but there's also an incredible supply of capital that the government can borrow still fairly cheaply. So how do you think of that? But there's no market discipline there.

02-00:26:10
Holtz-Eaton: So the question has always been what does it take to get Congress and an administration to fix the deficit? And one has always been smart public policy, willfully self-inflicted go—and that's never been the case. It's always been a crisis that forces you to. High interest rates in the nineties, Rubin saying, "If you don't do this we're going to be in trouble." And you can still make that kind of case. I believe though we're starting to see on the ground the public reward fixing the deficit instead of punishing it. Traditionally they punish people who raise taxes and cut spending. We'll see if I'm right. Certainly all the things we've looked at in the polling and what went on in the 2010 cycle is completely at odds with polling history. All the pollsters say we've never seen anything like this. The question is will it stick? I don't know. We'll see. I hope so.

02-00:27:04
Sharma: Yeah.

02-00:27:05
Holtz-Eaton: But if you look, for example, at the President's budget for last year, we meet the technical criteria for downgrade as a sovereign borrower in 2014. Now, that's not far away and that's not something we should even risk. And so one would hope that that kind of urgency can get conveyed to the Congress and the Administration so that we actually change course. I find it incredibly troubling.

02-00:27:31
Sharma: Yeah. That's something that we've just taken for granted but it's allowed us to behave----.

02-00:27:37
Holtz-Eaton: Yeah. When I was at CBO in 2003, Moody's was coming by asking questions. They were looking at the long-term. They said, "Hey look, this line goes north, this is the revenue line. It doesn't go north. Explain how this is going to

add up." And I would say it doesn't. And they'd say, "Okay." And so implicitly our bond ratings have always assumed a fix. They've always assumed that the political system would come to a fix because at face value it's never added up.

02-00:28:00
Sharma: Right.

02-00:28:01
Holtz-Eaton: As we march down this path and we don't get the fix, at some point they're going to say, "Oh, we were wrong. There is no fix and down goes the bond rating."

02-00:28:09
Sharma: Well, that time doesn't seem far off.

02-00:28:10
Holtz-Eaton: And that's what I'm worried about.

02-00:28:12
Sharma: That's interesting. I'm amazed that they'd have credit risk analysts come to CBO.

02-00:28:19
Holtz-Eaton: Absolutely.

02-00:28:21
Sharma: Well—

02-00:28:22
Holtz-Eaton: They should explain this to us. You are the gold standard, right. Should we believe these numbers? I'd say, "Yes, you should believe the numbers, but you should also believe they can be changed." But they haven't been. And that's the decade that we lost.

02-00:28:38
Sharma: I see. Okay.

02-00:28:39
Holtz-Eaton: My view of what happened is we gave away our time in the Bush Administration. That's the big thing. And then we gave away our cushion in the crisis because we borrowed 20 percent of GDP overnight. So time and cushion are gone. Now we're up against it and that's the debt problem.

02-00:28:57
Sharma: I see. Okay. Just want to ask one last question about your time at CBO. Can you describe the sort of situation around your leaving CBO in 2005? Was this—

02-00:29:07
Holtz-Eaton: I was broke.

02-00:29:09
Sharma: Oh, okay. So it wasn't related to---

02-00:29:13
Holtz-Eaton: I would have loved to finish my four year term. I was having some difficulties with my personal life. Ultimately I got divorced. I was broke. And as much as I was willing to live a leveraged existence on behalf of the Congress, it was over. And it was really sad. I did not want to leave.

02-00:29:40
Sharma: Do you want to do some follow-ups right now?

02-00:29:44
Meeker: Yeah, I'll do some follow-ups..

02-00:29:47
Sharma: Sure.

02-00:29:50
Meeker: At the beginning of the conversation, when you were sort of talking about your broad thoughts around economic policy, and the degree to which it's not really possible for the government to raise and lower levers to really influence the economy in a particular way. I just maybe want you to comment on something I read recently in Alan Greenspan's memoir when he was talking about engineering what he described as the soft landing in 1995, whereas it looked like there was a recession on the horizon and by I believe raising some interest rates he claims that they were able to engineer a soft landing. I wonder, from your perspective of being in academics and also being in government, how you think about what he had to say about the economy in relation to the ability of the federal government to engineer a soft landing at that point in time.

02-00:30:54
Holtz-Eaton: So here's how I would think about it. In 2001, we passed a tax cut that was perfectly timed to fight a recession. That tax cut was a tax cut that Bush campaigned on for eighteen months before that and was never advertised as an anti-recession antidote. It was something he wanted to do, which means every now and then you get lucky. There are levers you can pull and sometimes they hit at exactly the right moment. But that shouldn't delude you into thinking that you know which lever to pull all the time and that you'll pull it in a timely fashion. The Fed works very hard to manage short term rates and I have no doubt about their intention or the fact that they have levers that influence the economy. We know that they have influence. Their capacity to engineer a soft landing means they did it once. Good. But don't kid yourself into thinking you're going to do this perfectly all the time. They never have and they won't. [laughter]

02-00:31:59
Meeker: Well, so do you think that perhaps—

02-00:32:01
Holtz-Eaton: That's a monetary policy example of getting it right once. The fiscal policy of getting it right once. Neither convinces me that you should convince yourself to do that all the time because you'll always get it right. Those are different.

02-00:32:14
Meeker: And it throws you into a dangerous situation—

02-00:32:16
Holtz-Eaton: Throws you into a dangerous—yeah.

02-00:32:16
Meeker: —because you feel like that you are a master of the fiscal destiny of the United States.

02-00:32:22
Holtz-Eaton: And there's a bigger danger and this is one that I think is real and is a foot in the United States right now. Because politicians—and economics have played into this—have claimed that they can do these things, engineer recoveries, stop recessions, all that stuff, when they fail people can only come to one of two conclusions. Either they're evil, they don't care that the suffering is going on, or they're stupid. We got the wrong guy. When, in fact, neither could be true. But that's a danger. And that's how we treat people now.

02-00:32:55
Meeker: And that then perhaps results in the rise of particular vociferous political movements on the left or the right.

02-00:33:01
Holtz-Eaton: Sure. Absolutely. Plays right into it.

02-00:33:03
Meeker: Well, you had mentioned that actually applying automatic stabilizers, I think was the term you used, was perhaps the path that should be used perhaps both in fiscal as well as monetary policy.

02-00:33:18
Holtz-Eaton: Absolutely.

02-00:33:20
Meeker: Can you maybe unpack that a little bit and say what that might look like?

02-00:33:24
Holtz-Eaton: So traditionally automatic stabilizers on fiscal policy are the easiest. So unemployment insurance. More people get unemployment, government spending on unemployment automatically goes up. You're injecting cash into the economy in the way they always talk about. Money in the hands of the people. But as the economy improves it ramps back down. It's not like you're passing a program and it's not like you have to, in the moment, figure out the right people to get the money. You've got a program set up that says the deserving people are those who have had jobs and have now lost them and we

will spend more as there are more of them. And so that's a classic automatic stabilizer. A progressive tax system is a classic automatic stabilizer because if the economy slows down and incomes drop, people move down in the tax brackets, taxes actually get cut automatically. But on the flip side, when it starts roaring again it moves right back up. So rather than having Congress passing tax cuts, that happens automatically. So you can build into your tax and spending policies things which are geared to the state of the economy.

02-00:34:34
Meeker: So you—

02-00:34:30
Holtz-Eaton: Now, the downside to that—just want you to understand why this doesn't happen.

02-00:34:32
Meeker: Sure, sure.

02-00:34:33
Holtz-Eaton: That means Congress isn't doing anything. In a crisis they're not doing something. Again, because we've told people that it can be fixed, they ought to be doing something to fix it, and so doing nothing is unacceptable.

02-00:34:46
Meeker: So when you say progressive tax rates, do you think that there are too few tax rates now? That there should be more of them?

02-00:34:53
Holtz-Eaton: Because it's not a broad-based tax. It's not on everybody. It's just become this high-end surtax and that's the group that is least affected by business cycles. They have a lot of things which are not labor income sensitive and so it doesn't serve that role.

02-00:35:03
Meeker: Interesting. Okay.

02-00:35:07
Holtz-Eaton: The other problem we just don't know the answer to is our last two recessions are bubble-driven recessions and all the things I talked to are about income. Income goes up and down and you change people's income, the sort of cash coming in and out each year. We don't know what to do when housing values bounce around or stock values. Stabilizing, that's a harder thing and that's an open question.

02-00:35:27
Meeker: Okay. You had also mentioned that you worked at the CEA for the first Bush administration.

02-00:35:33
Holtz-Eaton: Yeah.

02-00:35:31
Meeker: ’89 to ’90.

02-00:35:35
Holtz-Eaton: Yeah.

02-00:35:35
Meeker: What role did you play there?

02-00:35:37
Holtz-Eaton: I was technically a senior staff economist. There’s members. Chairman was Michael Boskin. John Taylor, who had been one of my mentors at Princeton was a member and Dick Schmalensee from MIT was a member. And then we were the staff underneath them, the sort of geeky academics that they bring in for a year or two at a time.

02-00:35:56
Meeker: Actually, the first Bush administration is quite interesting to us. It comes at a particularly interesting time after the deficits and the increasing debt of the Reagan years. And there’s this sense that Bush is going to come in and perhaps moderate what some people, both on the left and right, describe as some of the excesses of the 1980s. There was also a recession on the horizon. Many people were predicting that. Of course, in 1987 there was the sort of massive—

02-00:36:27
Holtz-Eaton: The crash.

02-00:36:28
Meeker: —stock crash. Greenspan was newly appointed and interested in continuing the Volcker tradition of keeping the reins tight on inflation, so he was willing to raise interest rates to make sure that inflation wasn’t going up. And, of course, then there’s also the problems that were becoming apparent with the Gramm-Rudman-Hollings legislation, that it didn’t really give much wiggle room in periods of financial crisis. And so then you have the 1990 budget negotiations out at Andrews Air Force Base—

02-00:37:09
Holtz-Eaton: Oh, yeah.

02-00:37:09
Meeker: —that result in the Budget Enforcement Act, which many claim sunk the Bush administration because he relented by raising taxes, whereas during the 1980, in the election, he had said that he wouldn’t. From someone who worked in the CEA, after setting all of that up, I’m wondering if you can just give me a sense. We’re scheduled to be interviewing Dr. Boskin, as well as Dr. Taylor. They’re both out at Hoover, so that’s convenient for us. But from your perspective as a staff economist there, what role did the CEA play in really that negotiation and what directions were you getting from the White

House regarding the degree to which they were willing to compromise with the Democratic Congress at that point in time?

02-00:38:07
Holtz-Eaton: Well, the first thing to note is that Michael's headed off to Andrews every day. He was just gone. And we know that the discussions went on, but I'm not in the room and so you're trying to infer when he comes back and he's asking for stuff. So it's a lot of he comes back, "I need these things," goes off the next day and so there's a lot of late night crisis work. And the crisis work all revolves around taxes and so you know that they're talking about tax increases. There's lots of wordsmithing that you can see going on. Tax revenue increases versus tax increases. There's a lot of looking in the data for tax cuts that raise revenue. So capital gains tax cuts. Do they really raise revenue? Vociferous battles within the administration about that and good tax policy, lower taxes and savings versus not. So you know it's going on. There's no question. But in the end, this was Dick Darman's show and he left that legacy and the President let him. He gave him enormous power in that Administration. There's no question. To me, it was a real lesson. I'm not a political animal. I just sort of watched it. The key there, as near as I can tell, is that they didn't get any Congressional Republicans on their side. You want to be isolated, fine, but that's not going to be fun. And that's what they did wrong.

02-00:39:33
Meeker: So you see it as a political lesson in some ways?

02-00:39:36
Holtz-Eaton: There was no question that there were substantive improvements in the BEA. Gramm-Rudman-Hollings was fundamentally flawed because it targeted the outcome, which is the deficit. And you don't control the outcome. The economy shifts and things like that. So they shifted to a regime where you controlled the inputs with discretionary caps and PAYGO rules and that's the right thing to do. I have no question about that. I, at least, understood raising more revenue. That had become a politically toxic thing but analytically it wasn't very complicated. Remains true today. But Republicans had developed this deep belief that you could raise revenues by cutting taxes, something I've never understood.

02-00:40:23
Meeker: Well, that's the supply-side revolution.

02-00:40:26
Holtz-Eaton: What should I have—

02-00:40:27
Meeker: The Laffer Curve, yes?

02-00:40:28
Holtz-Eaton: There's a famous saying that says there's nothing wrong with supply-side economics that can't be fixed with division by ten.

02-00:40:36
Meeker: Yeah, I think Charles Schultze said that.

02-00:40:36
Holtz-Eaton: Schultze said that first. And that's true for Democrats on the spending side. They do all their supply-sides on the spending side. We'll invest in kids and it'll all be fine.

02-00:40:46
Meeker: Thinking politically about this, and with the provision that you're not a political animal and the way you discovered it, it seems to me that the way that historians and observers at the time talk about it as that 1990 decision by the Bush White House to enter into this compromise with the Democratic-led Congress emboldened people like Newt Gingrich and perhaps newly established a new wing of the Republican Party that became ascendant throughout the nineties and perhaps is dominant today. What do you think of that interpretation?

02-00:41:27
Holtz-Eaton: I think it's overly broad. Go back to Reagan. Reagan is in many ways considered the intellectual forefather of exactly that wing. And he raised taxes in '82, '83. He's a better politician, that's all. [laughter] And the first Bush was a fabulous guy, I'm a deep admirer in a lot of ways, but he wasn't a great politician. [laughter]

02-00:41:56
Meeker: Well, it's interesting to actually go back. I listened to the speech. It was a very short speech when he basically was imploring the American people to understand that compromise is necessary. His rhetoric and his communicative skills were certainly not on par with Reagan or Clinton for that matter.

02-00:42:16
Holtz-Eaton: It is actually a really important lesson and it's the one that in this very partisan time I think people will need to remember, which is that in the end all bipartisanship starts with the White House because Congress is a partisan entity. It's got chairmen and ranking members and it's got majority offices and small offices. It's always going to be partisan. It's built that way. And so if you want to have bipartisanship, the leadership has to come from the White House. And he did that and I give him credit for the bipartisanship leadership. It got the deal done. It went through. It isn't like he didn't get it passed. He did get it passed. So in many ways it was successful. But he did not maintain his own political currency in the process, whereas more successful politicians somehow managed to also do that, Reagan being the leading example, and this President where I think the jury's still out. It'll be interesting to see how it plays. It's an extremely hard thing to do.

02-00:43:14
Meeker: Perhaps the turning point would be this past December for the Obama Administration.

02-00:43:17
Holtz-Eaton: We'll see. Yeah. I think the jury's out but it has to start with the White House. I'm convinced by our history of that. And special people are required to pull it off.

02-00:43:27
Meeker: Well, there are some observers that actually point to the 1990 agreement as establishing the framework by which the budget surpluses in the late 1990s were in fact possible.

02-00:43:36
Holtz-Eaton: Of course. Absolutely.

02-00:43:41
Meeker: As someone who is a Republican, how would you evaluate then the Bush administration? I think that there are still many Republicans who see him as a turncoat because he turned on the true religion and in fact raised taxes when many say that he shouldn't have. Just as a personal example. My parents, who had started out by voting for Goldwater, right—

02-00:44:06
Holtz-Eaton: Yeah.

02-00:44:07
Meeker: —voted for Perot in '92 largely because of Bush's tax increase. I just kind of wonder about the—yeah. On the one hand, this might be seen as an important moment in establishing a successful period in American economic history, whereas people who conceivably would appreciate and benefit from that economic history punish him or look up upon his presidency in a negative light because of the revenue increase that he sponsored.

02-00:44:43
Holtz-Eaton: I'm completely in disagreement with all of the above. [laughter]

02-00:44:47
Meeker: Okay. No, that's great. That's fine.

02-00:44:49
Holtz-Eaton: So first of all you have to say what happened in the nineties economically. And what happened in the nineties economically is that everything that we did in the late seventies and early eighties, all the deregulation, particularly of telecommunications and things like that—remember, when I was a kid it was a federal offense to have an answering machine on your phone. It was just stunning. And so we deregulated a lot of stuff in response to just a lost decade of the seventies. No productivity growth. And that continued into the eighties. In the 1980s, we invested basically all of producers' durable equipment in

new computers and nothing seemed to come of it. And then early in the nineties, and then certainly to the mid and late, suddenly all of that restructuring, the loss of the middle management in every big corporation—there was a lot that went on in the eighties people forget about. The sort of first time we did the outsourcing and downsizing and leveraged buyouts and all that massive deregulation restructuring took. And we got phenomenal productivity growth. And that was real. The dot.com bubble might have been a bubble but the productivity growth was real and the economy grew really in a very profound way. And I don't think it had anything to do with the agreement in '90. I just don't. I think the roots are much deeper and much longer lasting and they come with other things. That's when we saw the skill differential and the inequality begin to rise because you had to be able to use computers to benefit. It pervaded everything. So I think the real lesson, the budget lesson, is that it controlled spending in a very serious way. The Clinton administration guys would just complain about how hard it was to get something through and then ultimately the revenue poured in and we got surpluses. So I've never thought that agreement and the narrowing of the deficits produced an economic boom. I think Bob Rubin was a great salesman for that viewpoint and there was a reason he did it but I never thought it was right. And so I think the Republicans took all the wrong lessons from that. And they continued to get them wrong through the early 2000s, which is we're going to only talk about taxes when they should care about spending. Once you spend the money, you're going to have to pay for it one way or another, and they should care deeply about spending and they didn't. They spent all their time grousing about tax increases, which was just crazy. And so I think they've been on the wrong page for twenty years. [laughter]

02-00:47:16
Meeker: It's interesting. Maybe—

02-00:47:18
Holtz-Eaton: And then I have few adherents. One of the reasons Jim Nussle and I got along is he was the budget committee guy and he was a spending hawk. And lots of Republicans are tax hawks and all they do is talk about taxes. But if you're not a spending hawk, it's over.

02-00:47:33
Meeker: Why do you suppose that is? Yeah, okay. Yeah. It's—

02-00:47:38
Holtz-Eaton: Number one, people lose sight of history. When Reagan cut taxes, the top rate was 70 percent. By the time he left office, it was twenty-eight, implicitly thirty-three. We're in a different era and you don't get the same benefits of marginal rate reductions when you go from twenty-eight to twenty-five as you get going from seventy to twenty-eight. It could have been true then but that doesn't mean it's true now and they haven't learned that. It's simple on a campaign trail just to promise it'll always work.

02-00:48:10
Meeker: Well, there does seem to be this sense that many recognize the folly of supply-side economic theory but then it still seems to be trotted out time and time again.

02-00:48:22
Holtz-Eaton: That's because it's not wrong. It's exaggerated. The folly is sometimes in the size of the effects that are claimed and sometimes in the speed with which it'll occur. But it's never wrong to point out that good tax policy matters and that's the trouble. You can't just discard it. It's not like saying it's the rotation of Mars that causes the economy to grow. You could disabuse people of that quickly. Marginal tax rates matter and I believe that deeply. So I want to argue for good tax policy.

02-00:48:58
Meeker: Okay. Well, with that said, I'm wondering. You had mentioned Reagan's move in '82 to index tax rates to inflation as one of the great achievements of his administration. Might it also be possible to interpret that as one of the main reasons that we're in the current trouble that we are today? Because politicians need to give cake to the people, right, and it used to come in the form of regular tax cuts that were necessary because of the—

02-00:49:32
Holtz-Eaton: The inflation index. We just undid the inflation index, yeah.

02-00:49:35
Meeker: But now that's not possible for them to do and so in some ways it places the federal government in a position of approaching insolvency because—I kind of wonder if there isn't any sense that maybe some economists see that, given the political realities of the day, as perhaps mistake. I was reading maybe an article recently that even talked about removing that or going back to the pre-era in which tax rates were not indexed.

02-00:50:09
Holtz-Eaton: So, again, this is losing sight of the lessons of history, right. Why did we do something like that? Well, number one, it's made the Congress sort of acquiesce toward inflation and inflation has no benefits. And so it was important from that perspective and Fed oversight and things like that to establish that you're not going to reward inflation. I see no reason to unlearn that lesson. It's better tax policy to tax people on what they really earn than the mirage of what they nominally earn. And so to undo that lesson I think is a mistake. What we didn't convey to both parties was if you want to hand out a tax cut every year you better control spending. I have no objections if they want to cut taxes. That's their political prerogative and they can run on it and the people can demand it. This is, in the end, a retail democracy and people get what they want. But what they're getting doesn't add up. And there's no way around that. And I do think it contributed deeply to the not adding up because they do continue to take people off the roles and I think it's bad. The tax code's a mess as a result and things aren't adding up.

02-00:51:28
Meeker: I have one last question about this Medicare Part D.

02-00:51:30
Holtz-Eaton: Yeah.

02-00:51:31
Meeker: It's really interesting and I think that historians are going to have trouble explaining it years down the road, about how it was during the Bush Administration, of all administrations, that this was passed. But at the same time there were various proposals on the table that would have provided the benefits but less expensive and many criticisms of Medicare Part D are not based on the notion that drug coverage should be paid, right, but based on the notion that who is really getting rewarded. It's drug companies in the United States who are really basically getting a payout and that the United States is not doing all it can to get the best prices for the medication that's being given to the seniors. So, for instance, only drugs from the United States or produced in the United States, correct, are eligible for this?

02-00:52:29
Holtz-Eaton: I don't think that's true.

02-00:52:30
Meeker: No? Well, it was the notion about buying drugs from Canada, for instance, because that would have been less expensive.

02-00:52:36
Holtz-Eaton: The reimportation, yes.

02-00:52:38
Meeker: Yes, okay.

02-00:52:39
Holtz-Eaton: So there are two different issues. One, which is going and buying Canadian drugs at their retail prices and bringing them into the US and then the second is whether all drugs are manufactured in the US which are eligible on Medicare. I don't think the latter is true.

02-00:52:50
Meeker: Okay, all right.

02-00:52:51
Holtz-Eaton: Certainly they have to be FDA-approved facilities and things like that, which there are.

02-00:52:55
Meeker: Well, I guess I wonder from your perspective at CBO if you were creating projections for various other scenarios than what was—

02-00:53:07
Holtz-Eaton: We were asked numerous times if the Secretary of Health and Human Services could negotiate drug prices would this program be cheaper and the answer is no. I do not believe it would be cheaper. Whatever you want to think of the drug program, the competitive bidding aspects of bidding for those drug plans was overwhelmingly successful. We expected it to be successful, but it came in 30 percent cheaper than we forecast. What people forget is that all this pressure was put on us about our projections and we were way too high. The complaints that evolved were sort of ironic because first thing they said, "Well, drug companies aren't going to do this and so we have to have a government backup plan." That was a big part of the design. We spent hours on these backup plans for regions and things and they could have the secretary negotiate and then so would those prices be different and we worried through all this stuff. We came to the conclusion that there was no particular leverage that the secretary had that would negotiate a better price. But the way it actually evolved is prices were much lower than we expected, 30 percent, and plans were everywhere. Remember, the complaint at first was there's too many choices. Seniors can't pull this off. It's a classic example of just how difficult it is to do this well. We tried to anticipate the workings of a product that didn't exist in nature. An insurance contract for the cost of outpatient pharmaceuticals. There was no such thing in the United States or anywhere and so we had to imagine what the bidding would look like, what the take-up would look like, the whole thing. And I think we did a great job and we weren't even close. [laughter]

02-00:54:46
Meeker: And what the use of the medication would look like now that the benefit existed.

02-00:54:48
Holtz-Eaton: Sure, yeah.

02-00:54:48
Meeker: That's the—

02-00:54:50
Holtz-Eaton: Yeah. What would the formularies actually be and on those formularies where would people locate? I think that's the best aspect of it. The other aspects, the fact that we're 75 percent subsidizing the richest Americans in those program and other things is hard for me to defend.

02-00:55:12
Meeker: Okay.

02-00:55:13
Sharma: Well, we're almost out of tape.

02-00:55:13
Meeker: All right. Then I'll stop there.

02-00:55:15
Holtz-Eaton: Okay.

02-00:55:15
Sharma: Okay.

02-00:55:16
Meeker: Excellent. Yeah.

02-00:55:18
Sharma: That was great.

02-00:55:18
Meeker: Excellent.

[End of Interview]