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Rudolph Penner

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
in 2010

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It is recommended that this oral history be cited as follows:

Rudolph Penner, "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" conducted by Patrick Sharma in 2010, Regional Oral History Office, The Bancroft Library, University of California, Berkeley, 2011.

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01-00:00:03

Sharma: This is Patrick Sharma here on December 8, 2010, with Rudolph Penner, tape one.

So, Dr. Penner, I'd just like to start a bit with your own personal background, and how you became interested in issues of public finance and public economics.

01-00:00:21

Penner: Well, it goes back to graduate school, and I actually wrote my dissertation in the field under Richard Musgrave, who is one of the great men of public finance. Then I became a professor at the University of Rochester, where I taught public finance. In those days, public finance was about 95 percent tax policy, and only about 5 percent, really, scrutinizing spending. While I was at Rochester, I went on leave for one year at the Council of Economic Advisors, and there I did fiscal policy for the members. At that point, I got much more into the spending side of the budget, and went back to Rochester for a time, and really changed my course quite considerably to spend a lot more time on the spending side. In 1973, I came back to Washington as a deputy assistant secretary of HUD [Office of Housing and Urban Development]. From there, I went to OMB [Office of Management and Budget], where I was the chief economist in the Ford administration, and really got deeply into budget matters at that point.

01-00:01:37

Sharma: I'd like to stop you here, because I think it's an interesting chapter. How exactly did you end up at OMB, and what were the main issues that were facing you in the Ford administration?

01-00:01:46

Penner: Well, I was, in essence, chief economist at HUD. At that time, the secretary was James T. Lynn. When Nixon resigned and Ford came in, Ford asked Lynn to be his budget director, and Lynn took me with him, as it were, over to be chief economist at OMB. That was a tumultuous time. The recession of '74 was well underway, actually, as I was transiting to OMB. It was a very sudden, unexpected, very deep recession, which we were changing our economic forecast every other week, and making it worse as we went along. That created what was then the record-breaking deficit, I think, in American history, although pretty tiny by today's standards.

01-00:02:49

Sharma: Right, everything seems sort of small. What was the thinking about the deficit? Why were people concerned about it at the time? Or were they concerned about it?

01-00:02:59

Penner:

Well, you really had two conflicting issues. One was to try and provide fiscal stimulus, and the other was to keep some control over the federal deficit. These are, needless to say, in opposition to each other. It's exactly what Obama faced when he came into office, really. Ford was a traditional Republican who very much believed in balancing the budget. But that did not prevent us from engaging in a number of stimulative measures. Tax cuts and so forth. You had, after Watergate, an extraordinarily liberal Congress was elected. They were very strongly pro-spending. So there was a constant struggle between the administration trying to rein in what would be very stimulative actions, and the Congress pushing for more and more spending.

01-00:04:04

Sharma:

I see. Did the 1974 Budget Act impact Ford's economic policymaking at the time?

01-00:04:12

Penner:

Well, that's very interesting. First of all, to go back a little bit, if you look back to the Nixon administration, when the Budget Act was being formulated, it's remarkable how little they intervened in that, because you would—

01-00:04:31

Sharma:

They being the?

01-00:04:32

Penner:

The Nixon administration. You would have thought the president would see it as a great reduction in his budgeting powers, which it was. However, that was the time of Watergate. That was the time when the last thing that the Nixon administration wanted to do was to annoy anybody in the Congress, because they were very worried about impeachment. So they stayed totally out of the formulation of that act. I think, even as we went into the Ford administration, it was not really recognized how important it was. Indeed, the Congress was very annoyed with President Ford on a couple of occasions. We violated the rules of the new budget process. We didn't make our recommendations at the right time, and so forth. So, there was some considerable conflict there, and I think it took a good deal of time before the executive branch really adapted to the new congressional budget process.

01-00:05:33

Sharma:

I see. Well, we'll revisit this issue in a moment. But you mentioned that Ford was an old-time Republican who was concerned with balanced budgets. What, exactly, if you can recreate this, was the reason that people were concerned with budget balance? Was it a fear of inflation, or crowding out of private investment, or was it sort of a more realistic sense that this is government out of control?

01-00:05:59

Penner:

Well, I think you have to go back to the founding of the republic. It was just a tradition that budgets should be balanced, that you should pay for the

government spending you did. It was partly more realistic, it was a rule intended to discipline government. Then, of course, the Keynesian revolution came along, which said that there are certain circumstances where it's actually good to run deficits. The problem with that was that Keynes never offered a substitute rule that would provide some discipline. So, you had a situation where people could argue for deficits either because there was a recession, there might be a recession, or the recession was too slow in ending.

01-00:06:55

Sharma:

I see. That we weren't at full employment.

01-00:06:58

Penner:

That's right. And even at full employment, people would see a recession around the corner. So, Keynes and Keynesians never offered any rule that would discipline budgets, in place of the old fashioned balance the budget rule. Now, there were many attempts. For example, Herbert Stein, after World War II, invented the concept of a cyclically adjusted budget that should be balanced over the business cycle. But I worked for Herb at the Council of Economic Advisors, and on numerous occasions, saw him try to explain this concept to the press corps, and it was hopeless. They just didn't get it. It was not something you could sell to the public. So we really had no disciplining rules. So I think it was partly morality; you should pay for what you're spending. Partly the notion of disciplining the size of government.

01-00:08:05

Sharma:

Was Ford concerned, or, at least, were people concerned about this as a political issue, that if the deficit got out of control, Ford might be criticized, and lose reelection?

01-00:08:20

Penner:

Well, I wouldn't put it that way, because it was, I think, clear to everybody, and the public and the press and everybody, that Ford was a fiscal disciplinarian. As I said before, the Congress was very, very liberal and pro-spending at that point. So it was very clear where President Ford stood. It wasn't really the big political issue of the next election campaign. That was the Ford pardon of Nixon, which I think did him in, finally. Plus, the recession.

01-00:09:00

Sharma:

What were your own views on fiscal policy as they evolved, during your time in the Council of Economic Advisors, and then up through your tenure as chief economist at OMB? You were obviously concerned about unbalanced budgets, but in what ways did your views evolve, or how did you come to your views on the deficit?

01-00:09:23

Penner:

Well, I guess I'm an old-fashioned fiscal conservative too. Prefer balanced budgets when you can achieve them. At that time, I was probably more of a Keynesian than I am today, as well. So, the question really was, how do you

plot a strategy that maintains discipline on the one hand, while at the other hand, trying to formulate a counter-cyclical strategy? We worked very hard on that at the Council of Economic Advisors. In fact, Herb Stein and others there formulated a very complicated strategy involving what the path of the cyclically-adjusted budget should be at that time. Now, it was never really implemented, and basically, what happened was—well, first of all, when I was there at the Council of Economic Advisors, that was '70, '71, and we had a very mild recession in 1970. That's when these ideas were formulated. But then, quite contrary to the advice of all his advisors, Nixon clearly wanted to goose up the economy for '72, and ultimately went to wage and price controls. Which was a major economic disaster. I, in fact, became a price controller for a brief time.

01-00:11:08

Sharma:

I don't want to take you away from too far from your thoughts, but about the issue of inflation, more broadly, were you concerned, and were others concerned about what, at the time, was really creeping inflation would accelerate much more as the seventies progressed, but did you see rising inflation as a result of unbalanced budgets at all? Or fiscal policy, more generally?

01-00:11:32

Penner:

Well, I think then it was a more monetary policy issue. None of us understood, at that time, the extent to which the world had changed from one of quite stable prices, as we had in the 1960s, and this new era, where inflation really became embedded in the economy. After I left the Council of Economic Advisors, I was involved in the budget project of AEI [American Enterprise Institute], where we all took sections of the budget, and we wrote about them. So naturally, we had to have consistent economic assumptions, and I remember vividly, I argued for assuming 4 percent inflation. My colleagues wanted 2 percent inflation, thinking that we would quickly come back to the kind of situation in the sixties. Of course, the relevant time period turned out to be double-digit inflation, eventually. It wasn't just us that made this huge mistake. The whole economic profession, I think, was in a similar camp at that point.

01-00:12:54

Sharma:

In retrospect, do you have any explanation for why people failed to anticipate the inflation of the 1970s?

01-00:13:02

Penner:

Well, economists are very prone to extrapolating from the recent past, and assuming it'll go on forever. We did that with the rate of economic growth, by the way, which is a whole other issue. But the 1960s, in retrospect, is one of the fastest-growing periods of American history. At the time, it was a tendency just to assume that would continue through the seventies and eighties and so forth. Similarly with inflation. We just extrapolated the sixties,

and thought, to the extent, the inflation rate went above those levels, it was a temporary phenomenon.

01-00:13:42

Sharma:

I see, that productivity would be increasing at such a level that—

01-00:13:46

Penner:

Well now, in our world, we get monetary policy and fiscal policy under control, or we would not be—

01-00:13:53

Sharma:

I'm really interested in your time, your brief period of time, at the American Enterprise Institute. Particularly as it might give us a sense of what, at least conservative thinking about budgets and deficits was during this transitional period in American history. Can you describe some of the contours of thinking within AEI about deficits during the time you were there?

01-00:14:18

Penner:

Well, frankly, I was one of the few people who worked on the budget as a whole. It's hard to characterize AEI thinking, first of all. It's not a monolithic organization, to say the least. Indeed, Bill Baroody, the president then, his motto was, "A competition of ideas." That was true within AEI as well as outside. On the other hand, I had the good fortune to be there with Herb Stein and Willy Fellner, two really major intellects in macroeconomics. I think we shared the same basic conservatism. I mean, this is old-fashioned conservatism, not the new conservatism. Now we're kind of left wingers by comparison to the rest of the world. But the old-fashioned conservatism about trying to limit the size of government. Yet, Herb was certainly a Keynesian, as was Willy. So, again, it was in that context of the conflict between, on the one hand, trying to control the growth of the government debt and the growth of government for that matter, and recognizing a need that, from time to time, you need some fiscal stimulus.

01-00:15:52

Sharma:

Was this really a focus on, with budgetary matters, the size of government? Earlier, you mentioned that public finance, at least, the study of public finance was all about taxation. So what was the thinking about the revenue side of the equation, if there was any during the time?

01-00:16:08

Penner:

Well, actually, thinking about the revenue side has changed remarkably little in the forty years that I've been looking at it, in the sense that it's almost a mantra of economists that you should try and keep the tax base as broad as you could possibly keep it, and keep rates as low as you could keep them. In other words, raise as much revenue relative to the size of the economy as efficiently as you can. And equitably. That basic presumption hasn't changed at all. Throughout that period, there have been differences between economists as to how important marginal tax rates are to the incentives to work and to save and so forth. But the more conservative group, thinking

they're more important than liberals, tend to. But of course, in recent years, we've had this rise of so-called supply-side economics that's been very important in the Republican party, which has notions as to the incentive effects of taxation that are outside the mainstream of economics thinking.

01-00:17:30

Sharma:

Well, I'm glad you mentioned that. It seems as if the supply-side theory was really percolating during the late 1970s, with Jack Kemp's proposals for a large tax cut, stimulative sort of tax cut. What was your thinking about this, if you can recall at the time?

01-00:17:52

Penner:

Well, it was percolating in academic life as well, with people like Marty Feldstein writing a lot about these kinds of things, and emphasizing the incentive effects of taxation. But the quantitative responses to changes in tax rates that academics were estimating, even those who were considered one side of the spectrum, like Marty, were tiny compared to the kind of assumptions that supply-siders would like to make.

01-00:18:26

Sharma:

I see, okay. So there was, more or less, a consensus on the need for certain tax reductions. But what ended up happening with the Reagan revolution was of a much greater magnitude, is that correct?

01-00:18:39

Penner:

Very much so. Maybe I should stop you there. The original Reagan tax cuts were huge, but it should be pointed out that, almost immediately, they started taking them back, with the TEFRA [Tax Equity and Fiscal Responsibility Act] payroll taxes in '83, DEFRA [Deficit Reduction Act] in '84. Gramm-Rudman in '85. And on and on.

01-00:19:05

Sharma:

Right, specifically because they were worried about the deficit.

01-00:19:10

Penner:

Yeah. Again, given economists' tendency to extrapolate, once double-digit inflation hit, it was assumed it'd be very difficult to get rid of it. A large part of the Reagan tax cuts were designed to stop inflation from pushing people into higher brackets. Then suddenly, with Volcker's dramatic monetary policy actions, inflation disappeared. Well, not disappeared, but went down far more than any economist had forecast, and that meant that in real terms, the Reagan tax cuts were much bigger than he had anticipated. I once made the crude calculation that, in fact, the '82, '83, and '84 tax increases essentially made up for that mistake.

01-00:20:08

Sharma:

Oh, I see. Combined with indexation and the coming down of inflation.

01-00:20:12

Penner:

Well, but that didn't take hold until '84, was it? I forget.

01-00:20:19

Sharma: Okay. So, from your perch, at least, during the early 1980s, did you see any sort of divide within the Republican Party over the people who were subscribed to the old time religion about balanced budgets, versus the supply-siders?

01-00:20:33

Penner: Yeah. Very profound divide, and indeed, been talking to prominent people. I don't think I'm divulging any secrets, but you saw Pete Domenici, for example, who was chairman—well, first of all, Republicans took the Senate in 1980 for the first time in I don't know how long. But a very long time. So, people like Pete were really agonizing. As he said one day, “Here we finally got the White House, we got the Senate. How can I go against my president, despite the fact that I'm very worried about what this means for deficits?” I remember Howard Baker calling it a riverboat gamble. They all went along with, because of some loyalty to Reagan.

01-00:21:37

Sharma: The political calculus was—

01-00:21:38

Penner: Not because they thought it was a wonderful idea.

01-00:21:42

Sharma: I see. So there's still sort of fiscally conservative Republicans in the Congress.

01-00:21:47

Penner: Oh, absolutely. The minority in the House at that time was even more so, I think. Except for Jack and his few colleagues.

01-00:21:58

Sharma: Jack—

01-00:21:59

Penner: Kemp.

01-00:22:00

Sharma: I see. One of the interesting things about this chapter, with regards to American budgetary history, are David Stockman's efforts, really integral efforts, to pass the first Reagan budget, and then the Kemp-Roth tax cut. I know you weren't directly involved in any of this, but was there a sense that, at the time, that Stockman was fudging the numbers a bit, and that these were overly optimistic projections?

01-00:22:26

Penner: Oh, absolutely. That, frankly, played a big role in making CBO [Congressional Budget Office] what it is today, in that because it was so

obvious that the administration assumptions were very optimistic, that people really turned to CBO for what they thought were more realistic assumptions. You had the irony of, when Marty Feldstein came in to the administration as chairman of the Council of Economic Advisors, in reaction to these very optimistic forecasts, he put out a very pessimistic one, which was more pessimistic than ours at CBO. So, it was really ironic, that. I remember Jack Kemp being very, very annoyed.

01-00:23:27

Sharma:

Certainly. Let's talk about your time as CBO director. How did you end up at the CBO?

01-00:23:33

Penner:

Well, I think, it's actually hard for me to know who played what role. But basically what happened is that I became pretty public criticizing the Reagan tax cuts and deficits. So I was a Republican. That caught the eye of Jim Jones, who was chairman of the House budget committee at that time. I was only the second director. There was a kind of notion developing at that time that the Senate had basically chosen Alice Rivlin, and now it's the House's turn to choose somebody. So Jim led the charge. He was a fan of mine, and he asked me to go to London on one of these congressional delegations, where they all met Mrs. Thatcher, and got various advice from her about how to get the budget under control. So I went along on that plane ride and got to know them. There was, essentially, the budget committee. Got to know them, and we hit it off well.

And then, after that, there was a struggle to get me appointed. Jim used the excuse, Jim Jones used the excuse that to maintain the bipartisan notion underlying CBO, that it'd be good to have a Republican lead it after a Democrat had, as the first director. But I think it was really because he kind of saw me as an ally in the deficit. But then, the next problem was convincing Tip O'Neil. I don't know that a Speaker had ever appointed a Republican to anything in his life. [laughter] That was a real struggle.

01-00:25:46

Sharma:

Well, can you go into that at all? What was—

01-00:25:50

Penner:

Well, I don't have a full understanding of what went on behind the scenes. But I do know that a delegation from the budget committee consisting of Jim Jones, Norm Mineta, Leon Panetta—who else was in it. Oh, Tim Werth was on the budget committee at that time. They all went to O'Neil and made the case for me, and then I had my interview with O'Neil, which was quite an experience. He was determined to scare me to death.

01-00:26:30

Sharma:

Oh, I'm sure. Sort of an intimidating presence.

01-00:26:32

Penner: Yes. It was so obvious, so it didn't really scare me very much. He read the law to me, he read the Constitution to me.

01-00:26:41

Sharma: He wanted to make sure that you were going to be neutral, in other words?

01-00:26:44

Penner: Yeah, yeah. I couldn't get a word in edgewise. I couldn't even say "yes, sir." [laughter] It was a total monologue. And I left and said goodbye, and that was about it. But I've heard since, I had never known this until a couple of months ago, that on the Senate side, Nancy Kassebaum had made a very strong case for me, and I didn't really know her at that time. So I thought that was kind of interesting. Howard Baker was pleased they were going to appoint a Republican, but he didn't really trust the process. It was kind of funny at the end, when it came to signing my appointment letter, that the Senate refused to do it until the House did it first.

01-00:27:38

Sharma: Because they wanted the House to go on record?

01-00:27:41

Penner: Yeah. Well, they were afraid the House will change its mind. So, it was a tough go. I was first contacted, Jim Jones called me, actually, in July. It was actually on my birthday in July, to ask whether I would be interested in the job. But I was not appointed until September. It took that long in negotiating everything.

01-00:28:18

Sharma: Among congressmen to do that.

01-00:28:21

Penner: Yeah. Well, and they conducted a search process too, where they had various candidates appear before the committee.

01-00:28:30

Sharma: Certainly since recently, definitely, the CBO is a very powerful institution, in that it can really kill legislation. Your colleague, Robert Reischauer's experience with Clinton's health care reform is probably exemplary. Was there a sense at the time that the CBO was this important institutionally, and that might account for some of the battles over your confirmation?

01-00:28:55

Penner: Well, I regarded that as my greatest challenge, to kind of institutionalize the role of CBO. With great courage, Alice Rivlin had really made it very independent. But CBO was still on shaky ground. It was not absolutely certain it would survive as an institution, and both Alice and me got threatened many times that our budget would be zeroed out because of some terrible thing we had done, some terrible estimate we had made. So, I was very desperate to maintain her tradition and to slowly build up CBO.

01-00:29:47

Sharma:

What did that entail? What was the institution that you found when you entered in 1983?

01-00:29:52

Penner:

Well, she had really set it up very well. There were some things that I disagreed with from the outside, but when I actually saw them from the inside, I saw that there was really no other way to organize the institution. So, it was really a question of, well, I guess, two things I thought were necessary for the institution to survive. One is that I had to have a lot of allies in academic life. In other words, the work had to be academically respected. Academics aren't very powerful, but they would at least rise up to my defense if I was really attacked too vigorously. And second, I courted the press unmercifully, so they would be on my side as well. Which they were.

01-00:30:54

Sharma:

This is really interesting to me. Were these formal links with academic community?

01-00:31:01

Penner:

Both formal and informal. Formal, in the sense, we had an advisory board mostly drawn from academics. Not entirely, but mostly from academics. Otherwise, from financial institutions, and some alumni from government life. Alan Greenspan was on my board. Secondly, to the extent possible, although we would have our work reviewed by academics, we often didn't have time to do that. The demand for results was too pressing. But where we had a study where there was a bit of time, we would try to send it out for review to academics of note on different ideologies, so that we'd be well balanced.

01-00:31:56

Sharma:

You made this known?

01-00:31:58

Penner:

Yes. I think it was. Maybe not really well known, but—

01-00:32:03

Sharma:

Were there instances where you got strong negative feedback from the academic community, or from people, particularly? What were the issues that people would disagree with?

01-00:32:10

Penner:

Not really, because Alice and I made sure the staff at CBO is relatively middle of the road and conventional in their thinking, so we wouldn't deviate from what the vast majority of academics believed on different issues. So, there were not major conflicts. There was ongoing conflict between the supply-siders and us, but they weren't academics, really.

01-00:32:47

Sharma:

But this had been over issues like dynamic scoring of tax cuts, for instance? Which never made it into CBO projections, is that my understanding.

01-00:32:58

Penner:

Well, there are a couple of things. First of all, we were always beat over the head for not dynamic-scoring tax changes by the *Wall Street Journal* and stuff. But we had nothing to do with scoring tax changes. That was the joint tax committee. The joint committee on taxation that scored. So it was kind of funny we'd be attacked vigorously by editorials.

01-00:33:23

Sharma:

Can you explain this to me, as a novice? What would the joint tax committee do, exactly? This was a congressional group.

01-00:33:32

Penner:

Yes. The committee that works for House Ways and Means, and {some in?} finance. They did the scoring for the committees, and we would use their scoring, really, only for personal income taxes and corporate taxes. We tend to use the Social Security for payroll taxes. Then we did our own scoring of important issues, like duck stamps and stuff like that. [laughter]

01-00:34:07

Sharma:

Simpler, sort of. I've got to ask, was this a strategy to politically insulate the CBO?

01-00:34:15

Penner:

No, no. The joint committee on taxation had a long history before CBO was created. There was a little bit of a turf battle, which I didn't like very much, between our respective staffs in terms of who would do what. And we would, occasionally, have longer run studies, more academic studies of certain tax issues. But actually, with Gramm-Rudman, joint tax made a strong pitch to me for codifying our respective roles, which my staff was very angry with. They saw me yielding turf to them. But, in fact, it was what they did, and what we did, and I had no problem with putting it in the law. But Gramm-Rudman codified this division of labor between the joint tax committee and us.

01-00:35:16

Sharma:

Is that the case to the present day?

01-00:35:18

Penner:

Yes.

01-00:35:19

Sharma:

Were there ever any discussion about integrating the two offices?

01-00:25:2

Penner:

There is. These days, people lob this suggestion over the transom every now and again. It'll never happen, because the Ways and Means and Senate finance regard the joint committee on taxation as their property. They would never let it go to CBO. So, I don't take these proposals seriously, but they do exist.

01-00:35:51

Sharma: I see, interesting. Were your efforts to reach out to the academic community and to court the press, for lack of a better term, innovations of yours, or did Alice Rivlin do some of this herself?

01-00:36:04

Penner: I think she did some of it too, yeah.

01-00:36:06

Sharma: Would you describe how you courted the press?

01-00:36:10

Penner: Mainly being very open with them and talking to them a lot. I seldom talked off the record; I was on the record most of the time.

01-00:36:26

Sharma: What were your goals, exactly, doing this, and did you feel constrained in any way as a director of the CBO from speaking out?

01-00:36:36

Penner: Oh, yes. Alice faced the problem that the congressmen thought she was getting too much publicity. So, that meant more publicity than they were getting. [laughter]

01-00:36:52

Sharma: Yeah, I'm sure they were jealous of anybody who gets any publicity.

01-00:36:55

Penner: That's right. So, at first, I really tired to cool it and just talk to them on substantive issues, and didn't want these personal profiles that they like to write, and those kinds of things. But I soon learned that if you didn't cooperate with them on things like that, they could get you somewhere. So I was just very cooperative with them regardless of what they wanted to do, and tried to give them information on our stuff.

01-00:37:28

Sharma: But where did you feel constrained, if at all?

01-00:37:32

Penner: Well, CBO director cannot make policy recommendations, and that's a no-no. So, you can only cite the pros and cons of specific policy options. That's very difficult when you deal with the press, because they want one side. You state the pro, and they're liable to want to end the interview, and you say, wait a minute, wait a minute! [laughter] There's another side, and sometimes I'd fail. So you'd get into trouble because it looks as though you're recommending something, when that was your last intent.

01-00:38:19

Sharma: Was this mostly the press coming to you—

01-00:38:21

Penner: Yes.

01-00:38:22

Sharma: —or were you going to the press? Do you remember any of the specific budgetary issues over which they were focused?

01-00:38:29

Penner: Well, the main focus during my time was the very big differences between the economic and budget forecasts of the administration and our forecasts. There was the whole rosy scenario controversy at the time.

01-00:38:44

Sharma: So could you go into detail about the relationship or relative stature of the OMB and the CBO? If you had any direct contacts with David Stockman's office, and then Jim Miller's office?

01-00:39:03

Penner: I had very few contacts with Stockman, even though I had known him when he was a congressman, and had met with him at that time. He stayed pretty aloof. Every now and again, he would call me, and we'd have a very perfunctory conversation about some issue or another. But I didn't have a lot of contact, and indeed, one of the hardest things to do as CBO director was to get your staff to talk to their staff. It's very difficult to get cooperation.

01-00:39:47

Sharma: Even at the staff level?

01-00:39:49

Penner: Even at the staff level, yeah. Simply because they're so busy and they don't want to be bothered into hearing a different point of view.

01-00:39:56

Sharma: [laughter] Yeah, just adds to the amount of work that they have to do.

01-00:39:59

Penner: Yes. Actually, that was one of my bigger disappointments, how hard it was. Interestingly enough, when Gramm-Rudman came along, we were forced to work together, and I think both sides then saw the great benefit to doing so. I had more contact with Jim Miller, because Jim and I had been longtime friends and colleagues at AEI, so we knew each other very well, and could talk to each other very candidly.

01-00:40:29

Sharma: You mentioned earlier that, in some respects, the CBO gained credibility with the revelations about the Stockman's budgetary gimmickry, for lack of a better phrase. Can you go into that at all? Another argument could be that the revelations about Stockman's manipulations could have just discredited the whole business of budgetary forecasting in general.

01-00:41:18

Penner:

Well, I suppose it could have, but we did really have great credibility at that time. By we, I mean CBO. That was reflected in press stories. They liked to beat up on the Reagan administration, so they would use our forecasts to do so. Even though, oddly enough, although our forecasting record was pretty good, basically the whole time I was at CBO, we were too optimistic. I began to think it was natural tendencies of forecasts to be too optimistic. Since then, they've gone through long periods of over-pessimism, and basically, none of our forecasts are very good when it comes to budget issues.

01-00:42:11

Sharma:

Right. It's a difficult science, so to speak.

01-00:42:15

Penner:

Well, even calling it a science is a bit of an exaggeration. There's a lot of art involved in it. One of the ironies that the press never noticed very much was that, while our GDP forecast typically was more pessimistic than the administration's, we made up for it, to some degree, by the fact that our assumptions led to the conclusion that more of the GDP would be taxable. So, our revenues were high relative to our GDP, whereas in the administration, it was the opposite. I had the suspicion, for which I have no evidence whatsoever, that the staff at OMB, so as not to be wildly wrong about the budget forecast, dampened. [laughter] Nobody noticed this, and this is going from GDP to incomes and what is taxable is very complicated and very difficult. Which also means you have a lot of latitude in what you're assuming. There was, in fact, one occasion where we had a much more negative forecast and more revenues than OMB. That's when I talked to Jim a lot. I thought, he'll never explain this to the press. [laughter] So we reviewed our estimates, and in fact, my staff, I think, had inflated them. Made a number of assumptions that were too optimistic about revenues given the GDP. So we got things in order.

01-00:44:01

Sharma:

Do you have any broad reflections about the art of budgetary forecasting, at least from your own experience, but then your observations of this process over decades?

01-00:44:14

Penner:

Well, I've actually written a lot about that, in a couple of articles. The forecasts are really very bad. It has to be admitted. Especially with tax revenues. That's very often not a problem of getting GDP wrong, but it is getting wrong the extent, sort of your estimate of the number of dollars in GDP that'll be taxable. And then even more important, in recent years, who that income goes to. In the late nineties, CBO was far too pessimistic, that they vastly underestimated how the income distribution had changed. You had, connected to the tech bubble, you have these extraordinarily wealthy individuals who are the top one tenth of 1 percent of the income distribution, became responsible for a very large amount of tax revenue. They totally

missed that. So, they were wildly too pessimistic about revenues during that period. The interesting thing about these forecasts, maybe only interesting to a technician, but in statistical jargon, they're serially co-related. That is to say, if CBO is too optimistic one year, the probability that it'll be too optimistic the next year is very, very high. That is partly because you have to make the next year's forecast before you understand why you were wrong last year. It's a long time lag before you get the actual tax return data that tells you where the income came from in great detail. So, you have very little choice but to use the same techniques and assumptions, except that if they were wrong last year, it's fairly highly probable they'll be wrong this year as well.

01-00:46:39

Sharma:

It does seem difficult, in general, to deal with a budget on a one year basis, right? That it's such a complicated business.

01-00:46:48

Penner:

Absolutely. And also, frankly, every forecaster in the world that you'll talk to, whether they work for the Congress, certain administration, or private financial institutions, will tell you it's just very dangerous to significantly change your techniques from year to year, because then your longer run forecasts are going to jump all over the place from year to year, and you'll lose all credibility with your clients. So, there's also an inertia for that. It's better to be wrong. [laughter] Consistently wrong than to jump all over the place.

01-00:47:28

Sharma:

I'm not an expert in this, but were there any innovations in the techniques of forecasting during your tenure at CBO?

01-00:47:35

Penner:

Well, there were innovations that didn't work. That was the time that so-called rational expectations economics was just starting, and the so-called Lucas critique—do you know about that?

01-00:47:53

Sharma:

A little bit.

01-00:47:54

Penner:

Well, the basic notion is it's foolish to use these structural models of the economy, because the structure is constantly changing. Partly because of the way expectations are changing, partly because of the way people learn how policies will be formulated, and so on and so forth. So there was a notion of using VAR analysis, variable auto regression analysis, where you just have one equation where you throw every variable you can think of into it, and estimate GDP, it'd be your dependent variable, and you'd estimate what that would tell you about GDP. We experimented with that, but it was wildly wrong compared to the kind of forecast—well, they were totally unreasonable forecasts. We never used them.

01-00:49:04

Sharma:

And you think that's because that was an invalid method, or was it because the economy just behaved differently?

01-00:49:11

Penner:

A couple of things. First of all, we didn't really use models. We consulted models in making our forecasts, but we had something we called our black box, so it's just a system of identities that had to be satisfied and check the consistency of our forecast. But a lot of judgment went into the forecast, as opposed to just blindly accepting the results of some model. The nice thing of having a model or our black box is that it relates everything, so if you think your model gave you an outlandishly high forecast for housing starts, say, you can reduce housing starts, and that would reverberate through the whole model in a logically consistent way. Then suddenly, it might see that if you adjusted that, then your productivity assumption went wacky or something else. So, you can keep iterating that way. With a VAR single equation model, there's no place you can put in that much judgment, really, in a logically consistent way. So, we can say the forecasts were logically consistent. They may have been very wrong, but at least they were logically consistent.

01-00:50:38

Sharma:

CBO is charged not only with giving broad forecast, but also evaluating specific pieces of legislation. So can you talk a little bit about that, any specific bills come to your mind over which there was debate within the institution over what they mean?

01-00:50:55

Penner:

Well, in fact, that is where CBO gets into most trouble. When I was there, we did about 700 cost estimates a year. Many are very, very trivial policy changes. That's when a congressman who very much favored a bill that you put too high a cost on for his taste would call you up and shout at you for a while. Or vice versa, an opponent of the bill might think you didn't put a high enough cost on it. Much of this stuff is very, very difficult, because there's no precedent. On some things, you can go to the economic literature for, say, elasticity demand for gasoline or something like that, and then there'll be an array of estimates. You can choose something in the middle, and you're okay. But a lot of these things, there's no precedent whatsoever. One I vividly remember, very trivial, but it involved a law that gave the plaintiffs against government in certain legal cases the right to claim damages. Not damages, I'm sorry, their legal costs. We put a cost estimate on it, and as things turned out, it didn't cost anything at all, because for some reason, judges never learned of this law, and nobody knew about it. [laughter]

01-00:52:45

Sharma:

It's not because no one ever won their case? [laughter]

01-00:52:48

Penner:

So there weren't any claims under it. So when it came time to renew the law, and the staff looked at it, and decided that judges were learning about this, and

other people were learning about this. So you put a similar cost estimate on it. Well, the staff at the relevant committee went wild. "This thing didn't cost us anything, how could you?" It would cost something now. That's the kind of fight you got into, which were very emotional, because this is under everybody's radar. The press doesn't—I talked about the importance of having the press as an ally, but they didn't even notice.

01-00:53:26

Sharma:

This is directly between you, and your office, and the staff?

01-00:53:30

Penner:

And the committee, yeah.

01-00:53:31

Sharma:

And the congressmen, yeah. Was this usually emotionally charged, and was it deeply substantive at any level? That is to say, how did you find Congress's budgetary sophistication at the time? Were they critiquing you on specific points in your estimates?

01-00:53:55

Penner:

They might well, and the critique might not have come from them or their staff, but from some lobbyists. All of these things require a lot of assumptions, and often there are other assumptions that are just as reasonable that you could have made, or almost as reasonable. So lobbyists often go with the assumptions that favors their point of view, obviously, and do competing analyses. So there is a lot of conflict. Now, I think there was somewhat less when I was there than there is today, because at that time, lobbyists still hadn't learned how important these estimates were in the legislative process. Now they know all about CBO scoring, and try to intervene at every stage of the game. But the more typical case would be that you just put too high a cost on something for the taste of backers of it, and they call you up and scream at you and hope that you would change your mind.

01-00:55:12

Sharma:

Do you remember any cases where you did change your mind?

01-00:55:16

Penner:

Well, if we were caught in an outright mistake, of course, we could correct it. But that was very rare, very rare.

01-00:55:24

Sharma:

OMB, you alluded to earlier, you had some relations with Stockman and Miller. But did OMB ever give you any pushback?

01-00:55:32

Penner:

Yeah. Well, not so much OMB, but the various departments where they were pushing. Say, I remember the Department of Education, I had an old friend who had a high political appointment there, and he complained to me hoping to change my estimates. Again, I was frustrated by the difficulty in that kind of occasion, where the Department of Education might have had a very good

argument, and I would like my staff to really work with them more. But it was very hard to arrange bureaucratically.

01-00:56:17

Sharma: It seems, also, just the time constraints. You mentioned just now that you had to score 700 bills a year. That's phenomenal.

01-00:56:27

Penner: Some of them at 2:00 or 3:00 in the morning.

01-00:56:29

Sharma: Yeah. We just have a few minutes left on this tape. So, just to finish up with this, can you talk a little bit about your actual management of CBO itself. I'm not familiar with how many people actually worked at the CBO during this time, but I'm sure you probably wanted to hire more.

01-00:56:49

Penner: Before I get into that, just one crisis that I faced. This was an appropriation bill—

01-00:56:59

Meeker: Can I ask you to hold off until I change the tape? I don't want to interrupt—

[End Audio File 1]

Begin Audio File penner_Rudolph_02_12-08-10_mono.mp3

02-00:00:04

Sharma: This is Patrick Sharma here with Rudolph Penner, tape two.

02-00:00:09

Penner: The Senate appropriations committee passed a bill that provided some assistance to Israel, and put in the bill a sentence that said, "CBO shall estimate the cost of this bill at zero."

02-00:00:31

Sharma: [laughter] Interesting.

02-00:00:33

Penner: Now, that was a real crisis for me. There's no way I could let that stand.

02-00:00:42

Sharma: That would set a terrible precedent.

02-00:00:43

Penner: It would ruin CBO, the whole process. So I had a very difficult conversation with Senator Hatfield, who was the chairman of appropriations at that time. He said, "Well, it's the law of the land. You got to do it or you're breaking the law."

02-00:00:59

Sharma: Interesting. What precipitated that?

02-00:01:03

Penner: Them doing that? Well, there's always a struggle in the Congress to show that what they want to do costs less than any reasonable person would think. It was simply that.

02-00:01:17

Sharma: There wasn't any personal history between the key legislator and—

02-00:01:20

Penner: I don't know if there was. But this kind of caught me, really blindsided me. Staff came running in with great agitation about it.

02-00:01:33

Sharma: How was it worked out?

02-00:01:36

Penner: I called Domenici, and he was chairman of the budget committee, attempting to solicit his help. He was kind of tepid about it, to tell you the truth. Then I called Hatfield and had this very difficult argument with him, and essentially told him it'd be a resignation issue for me. I couldn't allow that sort of thing, and he backed down.

02-00:02:04

Sharma: Was it a mounting frustration in Congress with CBO, or was it just a turf war type of issue?

02-00:02:12

Penner: No, it was perhaps almost an accident. Somebody's bright idea.

02-00:02:18

Sharma: Someone wanted to give you a hard time.

02-00:02:20

Penner: No, just wanted to make this cost nothing. [laughter] In the official estimates. Oh, you were asking about managing CBO?

02-00:02:31

Sharma: Yeah, the number of staff and the constraints on staff's time, how this looked from your perch.

02-00:02:40

Penner: We had about 200 people when I was there. The problem is that the work is very seasonal, and sometimes there's a flood of bills and the staff is literally working all night to try and do estimates. Other times, they're quite slack. So I never really made a pitch for more staff, because we had these times of relatively short times of frantic work effort. The frantic work effort was probably more of the time, but still, I felt it would be very difficult to justify more staff.

02-00:03:27

Sharma:

Did you treat all bills that came in the same, as far as time? Were there certain ones that you knew wouldn't get passed, that you might not devote staff resources to?

02-00:03:37

Penner:

No. The rule says that every bill reported out of committee has to have a cost estimate. Of course, people deliberating within the committee want to know. They want to know what your cost is like, what the cost estimate is like. So you really have to provide that service. And there were constant complaints that we didn't do it fast enough. Very often, what happens is in the committee deliberation, they'll change five or six words in the legislative language, has an enormous cost.

02-00:04:19

Sharma:

Change the whole meaning.

02-00:04:21

Penner:

Yeah. So, it is a very frantic task. But on the other hand, if you had one person charged with doing the kind of estimate of this business about legal costs that I mentioned, two can't do it any faster. I guess that's not always true. Sometimes a bill will have enormous number of provisions that I suppose you can get more people. But then, much of the time, they'd have nothing to do. So didn't do it.

Alice did not take big interest in this activity of CBO. She was more interested in the longer run policy analyses that were done. I think the staff was kind of shocked that I was very interested, and I didn't know. As you say, this whole activity, which is the most important activity of CBO, is not well understood outside of CBO, and I didn't understand it well as an outsider. But became very interested in it, and frankly, didn't know how much I should trust these things. Very early on, there was a big welfare bill that went through, and one of the provisions of the bill was that burial plots should no longer be counted in the asset tests for welfare eligibility. So I'm reading the cost estimate, and it says, "Costs \$1 million." I couldn't resist putting on a note, I said, "How on earth would we know that?" Who knows about burial plots? Well, the analyst who did it was incredibly insulted, and the next morning, she had piled on my desk all kinds of information about burial plots. Burial plots by industry. After that, I thought, I can trust these people. [laughter]

02-00:06:34

Sharma:

There's a big market.

02-00:06:38

Penner:

So I really learned to admire these people, who really work in the sub-basement of CBO, as it were.

02-00:06:47

Sharma:

I'd like to revisit the chronology a little bit, of your tenure at CBO. So you come in in 1983. This is a time in which the deficit problem is emerging significantly, that the tax cuts combined with the defense increase combined with the recession are pushing the deficit to unprecedented levels. Now, if you can walk us through how you saw this, what your views on the defense buildup, say, were, and whether you struggled to actually oversee any of the Defense Department appropriation bills, or anything like that.

02-00:07:28

Penner:

A couple of points on that. First of all, what I said before that CBO and its director cannot take policy positions, I thought it was safe for me to be against deficits. Seemed reasonable. And in my speeches and so forth, I felt I could, in the press interviews, talk about the dangers of deficits. I never got into trouble for doing that. There was the issue of estimating how big they would be, and there, we differed from the administration. As I said, our forecasts, I think, were much more reasonable. That's where we gained a lot of credibility.

In terms of things like the defense buildup, there we did the cost estimates like we always do. To the extent there was contention, it was about how budget authority would translate into outlays. So it's outlays—

02-00:08:36

Sharma:

Authorities versus outlays.

02-00:08:37

Penner:

Yes. It's outlays that determine the deficit, and in our review, the Pentagon was making outrageous assumptions. Hardly any budget authority would be spent. So, that was a big bone of contention, and the committee was very upset with us. Very often, there were proposals that when we differed with the administration, that we should get together, add up the estimates, and divide by two. [laughter] I, obviously, resisted that, saying it was our job to give you the best estimate we can possibly give you, regardless of what the administration is doing. So there was that sort of thing.

Once, got into a total—our appropriations, when we went up before the legislative subcommittee of appropriations of our own budget, that was the occasion for anybody in the Congress who had a complaint against us to come and beat up on us. One time, Senator Stevens said—he had to scream and shout at one of these hearings. It was some obscure issue where he felt we hadn't given him enough saving for something he did. Frankly, I didn't know what the hell he was talking about. I didn't have my estimator with me, so finally persuaded him to suspend the hearing, and again, he threatened to zero out our budget. Suspend the hearing, and find out what was going on here, get our staffs together. So we did that for about a half an hour, and it turned out that we had actually given him the saving he had wanted, but we had put it in a different part of the cost estimate than he expected.

02-00:10:44

Sharma: He never saw it?

02-00:10:45

Penner: He never saw it, and his staff never saw it. So, we settled this, and we reconvened the hearing. Not a word of apology, nothing. [laughter] As if nothing had happened. But he was screaming, and throwing papers, as Stevens could from time to time. But that's just an example of the kind of thing that went on.

02-00:11:16

Sharma: Can you describe, to the best of your recollection, the concern within Congress about deficits? I came across, in doing some research for this, Senator Dole had some hearings on the deficit in late 1983, and I believe you testified at those. It seems to fit, with you had fiscal conservatives in the Senate, specifically Domenici, Dole, Rudman, who had reservations about increased deficits.

02-00:11:48

Penner: Before I do that, I've been emphasizing the conflict over these cost estimates. It's probably more much important to emphasize that we did, as I said, 700 in one year, that was the most we did while I was there. Maybe two or three of these provoke confrontation. I was amazed how willingly the Congress accepted the vast bulk of our estimates, because some of them, I guess, were made on totally tenuous grounds. We had no precedent.

02-00:12:25

Sharma: Tenuous, but the best grounds that you can do.

02-00:12:26

Penner: Well, the best you can, but well, one of my favorites from Rob Reischauer's time was we made a loan to Israel. They had to estimate the probability that Israel would default on the loan. How do you come up with a number like that? And there are just a lot of things like that, where you had very little basis for your estimate, and yet, the Congress accepts them, and I think over the years, has—well, Doug Elmendorf tells me he hasn't ever had a threat to zero out his budget. Fairly common with me. So it really is institutionalized now, and that has to be emphasized. But I'm sorry, you were asking about—

02-00:13:16

Sharma: Oh, I was just going to ask about the rising concern about the deficit in the early eighties, and then these Dole, the Senate finance committee hearings in December 1983, if you have memories about this specific event, or the rising concern about the deficit.

02-00:13:34

Penner: Well, the concern about the deficit was always there underlying it. I talked before about Senator Domenici agonizing over the size of the tax cuts and the defense buildup, and Senator Dole was a real traditional Republican deficit hawk. It was through his legislative skill, really, that they passed TEFRA [Tax

Equity and Fiscal Responsibility Act] in 1982. I don't have the vaguest memory of these hearings. They testified about thirty times a year. But often, I testified expressing concern about the deficit. The other big issue at the time were the twin deficits, and there, I was probably wrong. But there was a notion that there was a direct link between the budget deficit and the trade deficit. That's all based on an identity, and it's hard, in retrospect, to see the causal flows. They moved in lock step with each other through that period to a remarkable degree. I concluded, probably wrongly, that they were very closely related. Subsequently, the relationship broke apart. Doesn't mean, by the way, they weren't related at that time, but I testified a lot about that too.

02-00:15:17

Sharma:

Tied up with that, there was a feeling that the US position in the world was declining, right, and somehow deficits were a cause of that. All of a sudden, Japan appears as a much more active economy. I know you don't remember these specific hearings, but one of the interesting things that we've touched upon already is this split within the Republican party between traditional Republicans who were concerned with balancing the budget, and the Reagan administration and other supply-siders, who were focused primarily on tax cuts. How did this play out, and specifically leading to the passage of Gramm-Rudman-Hollings in 1985?

02-00:15:55

Penner:

I don't think there, that split was very important. What happened was the Congress really worked hard after '81, really, to get a handle on the deficit. You had TEFRA passed with great difficulty. You had the Social Security reform in '83 that brought in a lot more payroll tax revenues. You had a less important bill in '84 that increased business taxes. And all this went on, and the Congress was shedding blood over this thing. Politicians, as you may have noticed, don't like to raise taxes and cut spending. Any sort of politician, let alone whether they're supply-siders or not.

02-00:16:47

Sharma:

But in retrospect, it appeared, compared to today, certainly much more willing to tolerate tax increases.

02-00:16:51

Penner:

Absolutely. Yet, the deficit didn't go down. Our forecasts were overoptimistic. Although, during the period, the actual course of the deficit was very disappointing. It was that growing frustration that led to Gramm-Rudman.

02-00:17:12

Sharma:

Just briefly, it seems, in retrospect, that the obvious reason why, in addition to the tax cuts and the defense buildup, the obvious reasons why the deficit was growing was that the economy was in recession, at least in the early eighties. Was there a sense among people that one shouldn't necessarily focus on the deficit, it's about accelerating growth?

02-00:17:38

Penner:

There were people of all stripes at that time, but neither the administration or any of the supply-siders rationalized the tax cut on a basis of Keynesian economics. It was all supply-side economics. There was a total rejection of Keynes among conservatives at that time.

02-00:18:05

Sharma:

Although the mechanism is still sort of similar, in a way, right? You can make the argument that supply-side is something of like the mirror image of a Keynesian argument. It's intended to use some sort of government stimulus. It's about stimulating the economy, primarily, rather than deficit.

02-00:18:20

Penner:

It is about it, in the sense of, yeah, accelerating growth. Yeah.

02-00:18:24

Sharma:

What was CBO's role in the formation and then the passage of Gramm-Rudman?

02-00:18:33

Penner:

That was probably my most difficult time at CBO. First of all, I wanted to remain neutral, but I saw Gramm-Rudman as basically unworkable, and probably not very useful. But, in the interim, all sorts of crazy things got put in the language in the bill. CBO was to control, I would likely say, and I could imagine, armies of angry people marching on CBO, and all sorts of stuff like that. I fought very hard to keep those things out. I probably made a big mistake in judgment, because they were so dumb, they probably would have been taken out without my intervention. But I was very worried for what this would do to CBO, giving it tasks that were essentially impossible. So, I did argue against them in various hearings, and that made Domenici very angry with me, and the Republicans who backed Gramm-Rudman very angry with me. Especially Senator Gramm. So they felt I was very partisan in that time, and I really didn't intend to be, but—I wouldn't say "ruin," but it reduced the friendliness in my relations with people like Domenici.

02-00:20:13

Sharma:

I'm not intimately familiar with this proposal to have CBO control outlays. Can you just extrapolate on that a little bit?

02-00:20:20

Penner:

You ask about the sophistication of the Congress with regard to budget matters. There is very little understanding up there about the relationship between budget authority and outlays. They control budget authority; that's what they vote on. They don't control outlays. But outlays get into the spending measure, which determines the size of the deficit. So Domenici, in particular, was always frustrated by the fact that he didn't really control outlays. We didn't—I was going to say we didn't forecast them that well, but probably shouldn't say that. We forecast them reasonably, but there was a lot

of uncertainty around our forecast as to what particular budget authority would mean for outlays in defense and other areas.

So that was a frustration, that, really, the Congress does not have direct control over the deficit, and Gramm-Rudman set precise targets for the deficit. So at one point in the proceedings, their solution to this was for us to somehow monitor and control outlays, which would have been—not impossible, but would put us into an operational role that was far—we wouldn't have the staff for it.

02-00:22:00

Sharma: You'd have to plant staff at each agency.

02-00:22:04

Penner: Not literally, but you'd have to monitor these things very, very carefully. Actually, the Pentagon does have some mechanism for controlling outlays, but it was just something I couldn't even imagine CBO doing.

02-00:22:23

Sharma: Wouldn't that have been unconstitutional? Obviously, the sequestering agent—

02-00:22:26

Penner: Actually, it was, yeah. Just even the role that the legislation gave us at first, the Supreme Court declared to be unconstitutional, or ultimately. But this was long after the bill passed.

02-00:22:41

Sharma: Oh, this proposal to have CBO control outlays was after?

02-00:22:45

Penner: No, no. That was taken out long before the bill was finally—

02-00:22:50

Sharma: Oh, okay, I'm sorry. It was just a proposal floating around.

02-00:22:55

Penner: Yeah. But the bill gave us some operational control in the sense that we were to make a forecast, and OMB was to make a forecast, and then we were to take an average, and that would be the basis for deliberation. And the Supreme Court said that put us in an operational role, which was unconstitutional.

02-00:23:18

Sharma: Were you, or the CBO, involved in setting the specific deficit targets, the deficit reduction targets?

02-00:23:26

Penner: Only in the indirect sense that they had to work from our baseline, and they had to look reasonable. It turned out not to be reasonable, but that was as much because of our forecasting mistakes as anybody else's.

02-00:23:42

Sharma: Do you remember any of the—I know you weren't party to them, but the debates over why balance the budget over a five year time, why not a ten year period?

02-00:23:54

Penner: Unfortunately, I was at fault. They called me into their negotiations, and that was a big mistake for me to go, because I usually held myself aloof from the actual nitty-gritty of drafting things. But CBO got involved in that.

02-00:24:13

Sharma: Because it was such a major bill.

02-00:24:15

Penner: Yeah, and it involved us so intimately that it'd get involved, try to give them technical advice as to what was reasonable and what wasn't. But that, as I said, got us a lot of controversy.

02-00:24:29

Sharma: Do you remember the lines of debate within those negotiations? I imagine there would be disputes over the speed of the deficit reduction, and also the sequestering relationship between defense and domestic spending.

02-00:24:45

Penner: The whole Democratic strategy in that time was to force Reagan to choose between his tax burden and his defense buildup. They saw Gramm-Rudman as a delicious opportunity to do that. Reagan totally fooled them. He didn't hesitate a moment but to start cutting defense. It was interesting in that regard. But that was their motive. So there was a lot of debate about exactly how you would sequester. That was more political, less technical, so we didn't get into that. Most of the debate that we got involved in was the forecasts underlying what they had to do.

02-00:25:41

Sharma: Because this would so fundamentally change the baseline projections. You just alluded to the fact that you were skeptical about Gramm-Rudman-Hollings. Why were you so critical of it?

02-00:25:58

Penner: It was actually partly to do with the deficit targets. I didn't know whether they were reasonable or not, but I did know that our forecasting accuracy was not such that we could tell him whether they were reasonable or not. I worried that they would be unreasonable and that the whole thing would fall apart, and in a sense, that's exactly what happened. First, they changed the targets, and

subsequently, of course, the whole thing fell apart when the sequester it would have been handed was gargantuan. That's when we got the budget deal.

02-00:26:48

Sharma: The 1990 Budget Agreement Act, yeah.

02-00:26:51

Penner: But I was long gone.

02-00:26:53

Sharma: How did Gramm-Rudman change the CBO, if at all?

02-00:26:57

Penner: I mentioned before, I think one really beneficial effect it had was to get the staffs of OMB and CBO to work together, and get to know each other and respect each other.

02-00:27:11

Sharma: This was during the gestation period, the drafting period?

02-00:27:16

Penner: Well, during the drafting period, but the first year, we did have this responsibility of preparing the forecasts.

02-00:27:28

Sharma: Can you walk me through this? I'm not familiar with the first year.

02-00:27:34

Penner: The original bill essentially said that CBO and OMB would make a forecast, and then you would take the average. In order to make it constitutional, they inserted the comptroller general, arguing that because he was ultimately appointed by the president, he was a creature of the executive branch, which was really a far-out theory. Obviously, the comptroller general works for the Congress. But that was the case they made before the Supreme Court. But in doing this—and there were all kinds of definitional problems, and if you had to sequester, exactly how you would do it. The first year, they built in a little sequester, it was tiny. But it still presented us with puzzles, like how do you sequester the House of Representatives' barber shop.

02-00:28:38

Sharma: [laughter] Wow, down to that level of detail.

02-00:28:40

Penner: Oh yeah. Had to be. So we had all sorts of puzzles like that, and we were sued. I was sued for some of our decisions, or the decisions about veterans' life insurance that the veterans lobby didn't like, in terms of how that should be sequestered. Actually, that was really funny, because OMB and us disagreed about it. The comptroller general took OMB's side on that issue, and we actually came out in favor of the veterans. But the veterans sued me anyway. [laughter] On the grounds that we might change our minds. So all

sorts of stuff like that. Anyway, there were a zillion issues that had to be resolved. This was a totally new thing.

02-00:29:40

Sharma: This was just the first year though, right?

02-00:29:41

Penner: Yeah. Then after the Supreme Court decision kicked the comptroller general and us out of the process, then OMB took it over, because the court said it was an executive branch operational responsibility.

02-00:30:00

Sharma: In retrospect, do you have any thoughts about Gramm-Rudman? It seems as if there is some debate over its effectiveness or ineffectiveness.

02-00:30:11

Penner: Maybe I was prejudiced, but I didn't think it was very effective at all, because they did ultimately change targets, and then ultimately, it fell apart. My deputy at that time was Ned Gramlich, and he and I disagreed about it. When he went back to academic life, he did some empirical work that he felt showed some effectiveness in reducing the deficit below what it would otherwise would be. I guess I remain skeptical. But the important thing about Gramm-Rudman was really its demise. So when it finally fell apart, partly because of some very clever manipulation by Dick Darman, it resulted in a vast improvement of the budget process, first of all with the mega budget deal between [George Herbert Walker] Bush and Congress. Then they enforced that deal with the Budget Enforcement Act of 1990, which also had the Credit Reform Act, which was very important, in it, without hardly anybody noticing.

02-00:31:26

Sharma: Can you describe that? You were gone from CBO at this point, but why are you more optimistic about the 1990 agreement than Gramm-Rudman?

02-00:31:40

Penner: The 1990 agreement did not set targets for the deficit. The Budget Enforcement Act simply tried to prevent the '90 agreement from eroding through time. One could imagine that if there hadn't been any enforcement mechanism, that Congress would gradually cut taxes and raise spending above the limits that were agreed to in that deal. So the Budget Enforcement Act put a cap on discretionary spending and invented the pay-as-you-go process for tax changes and entitlements, and those things worked extremely well. Well, until a surplus hit by total surprise in 1998. The sequence is really important. First you had the deal, and then you protected it. The protections didn't really reduce the deficit by themselves. Pay-as-you-go is deficit neutral; it just prevents you from making the deficit worse. There are no deficit targets here. So, the whole thing was much more workable.

02-00:33:01

Sharma:

But it was the deal itself, it was a political calculation to compromise.

02-00:33:05

Penner:

The deal was extremely important. Of course, again because of the recession of 1990, the Congress was very disappointed in how deficits actually evolved, and then you had the Clinton deal in 1993 in response to that. The '90 deal was bipartisan. '93 was 100% Democrats.

02-00:33:32

Sharma:

This is just sort of an aside; a riddle we're trying to solve is where the idea of PAYGO originated. Do you know specifically?

02-00:33:42

Penner:

It was Leon Panetta's staff. I'm not sure who on the staff did it. I'm not sure whether Joe Minarik was there. I don't know who actually came up with the idea. I, frankly, testified I was skeptical of it, because it was obvious that it was easy to cheat on through various budget gimmickry and so forth. They did a little of that, but remarkably little. They didn't start to really cheat on it until 1998, and then they started using outrageous budget gimmicks and emergency provisions and all that sort of stuff. Then in '99 onward, they simply would—the thing didn't expire until the end of fiscal '82, so they would simply put language in bills notwithstanding any other law.

02-00:34:40

Sharma:

2002, you mean?

02-00:34:42

Penner:

Yeah, 2002. They really violated it right and left at that point.

02-00:34:50

Sharma:

I'd love to get your thoughts; this is a much broader question about budgetary gimmicks in general. This is something that almost seems unavoidable. Or is it? Are there specific steps that could be taken to—

02-00:35:01

Penner:

No. In fact, I think one of the big mistakes with the Congressional budget process is that over the years, including with Gramm-Rudman, they've tried to amend the process to prohibit the most outrageous budget gimmicks. But it doesn't work. It's exactly analogous to the tax law. You try to close one loophole, you open others that you didn't intend to do. That's how it works with the process. But as a result of all of these efforts to reduce gimmickry, the process has become so incredibly complicated that nobody understands it anymore. You can hear debates among the staff of the budget committee as to what's permissible, what isn't, under the budget process. So if I were reforming it, I'd get rid of all that stuff and just have a simple process and hope that, when the Congress does something like define the Census to be a national emergency, [laughter] it would fall by its own weight. It doesn't. But hopefully, they'd just be restrained a little bit by their own embarrassment. Unfortunately, that doesn't work.

02-00:36:29

Sharma:

No, it doesn't. We had a chance to interview a former senator yesterday, and he was very pessimistic about the American public's real interest in deficit reduction, and said, no one's feet ever got held to the fire with this. So, nothing will be resolved until a crisis actually erupts.

02-00:36:49

Penner:

Well, yeah. That's often said by politicians, and yet, in the eighties, I don't know whether it was because of the basic beliefs of people like Senator Dole and Baker and others, but they did a lot of courageous things at that time to reduce the deficit.

02-00:37:09

Sharma:

It certainly seems as if the political calculus has changed a lot. I'm thinking specifically of the Republican Party's more or less lock step aversion to any sort of tax increase. Which seems to have been a big historical shift within the Republican Party.

02-00:37:25

Penner:

As an aside, I think that's changing now. Starting to change.

02-00:37:30

Sharma:

Oh really, okay. That concerns about the deficit are beginning to—

02-00:37:34

Penner:

Dominate.

02-00:37:35

Sharma:

—to outweigh—that would be interesting to see.

02-00:37:39

Penner:

I don't know if you noticed, but in the presidential commission, when Paul Ryan and [Jeb] Hensarling objected to the report, they didn't mention tax increases. In it, they talked about its failure to deal with health, which is a legitimate gripe. I talked to some real conservatives, and there's a weakening now, they're seeing tax expenditures as expenditures, and they don't like them. So there is, I think, a golden opportunity for some major tax reform. I'm very disappointed the president delaying the tax changes two years. They've pitched for using these two years to—

02-00:38:33

Sharma:

To do some of those reduce the tax expenditures and broaden the base?

02-00:38:36

Penner:

Yeah, even the more radical tax reform.

02-00:38:42

Sharma:

Maybe we can talk a little bit more about the current situation in a few minutes. But just one more chronological point; you left in 1987. I'm not sure you left before or after the 1987 budget summit that was precipitated by the stock market crash that October.

02-00:38:59

Penner: I left before.

02-00:39:00

Sharma: Before, okay. So you weren't observing that closely at all.

02-00:39:07

Penner: No, I didn't.

02-00:39:11

Sharma: Why did it take two years to name your replacement?

02-00:39:16

Penner: Well, I think, it sounds like a very strange thing to say, but naming a CBO director is not at the top of congressional priorities. They're all so busy that it's very hard to get them to focus on it, and the appointment process wasn't at all routine at the time. The basic problem with the appointment process is that the law says that the director shall be appointed by the Speaker of the House and the President pro tem of the Senate on the advice of the budget committees. It doesn't say what happens if the House and the Senate disagree. There's no tiebreaker in the law. That's the fundamental problem. It'd be nice to have a tiebreaker. Gradually, there's this notion sprung up, and frankly, I don't even know how strong it is today. That the House and Senate alternates in picking the directors.

02-00:40:26

Sharma: An informal agreement.

02-00:40:28

Penner: It's informal, and I don't think it's written, and I'm not sure even everybody agrees with it. It's in the background. It's a notion. That notion wasn't as powerful at the time when I left. I was pretty much a House candidate, and Alice was a Senate candidate, but that's not much of a tradition there. So it was partly neglect on the part of the Congress. CBO went on under acting directors and did the job. It was very difficult for CBO, because if you're acting, it's a terrible thing to be acting-anything. You don't really have the clout. They treated Ned Gramlich very badly in my view. Not really giving him a decision about himself. So, they just kind of stumbled along and ultimately decided maybe they should have a CBO director.

02-00:41:36

Sharma: That it became a priority eventually.

02-00:41:39

Penner: Eventually, yeah. But I think partly it was because a process had not become routine. Now they've been through it a number of times, there is this vague notion of alternating, which, in a sense, they've done.

02-00:41:55

Sharma:

It's a much more institutionalized part of government. It's part of the landscape, indelibly.

02-00:42:00

Penner:

Yeah. When Alice's term ended and they floundered about appointing a successor, she decided that she would remain in office, sort of to protect the place as it were, until they appointed someone. She had no notion it would take nine months. [laughter] In fact, there were "Free Alice Rivlin" buttons coming out on the Hill. I thought that just gave them an excuse for delaying, so I was bound and determined not to do that. So my term came to an end at the end of December of '86, and I did yield to the point that I said I would see the process through, all the hearings on the CBO baseline estimates and everything we did in January, and so forth. So I agreed to stay well until March. But I gave them a date certain that I was going to leave in March, come hell or high water. That didn't work either.

02-00:43:21

Sharma:

No, you just sort of still tie up some loose ends.

02-00:43:25

Penner:

Well, no, I left. I left. But it didn't work in the sense that it didn't give them any urgency to name a replacement.

02-00:43:33

Sharma:

I see. Do you have any broad reflections about your tenure in office? How the CBO changed under your watch?

02-00:43:42

Penner:

Well, I'm frankly pretty proud of the fact that it didn't change very much. I really saw my role is to institutionalize the practices that Alice had established. I like to think I improved the quality of the staff some. I think it, again, that wasn't Alice's fault or my great skill, but CBO was gaining a reputation as a very good place to work. Gaining some academic reputation, so I was able to hire some very good staff. I think the quality of our analysis went up. So I was pretty proud of doing nothing, in the sense of, in any way, changing the organization nor the practices of CBO. I made a big effort not. Alice was pretty good about not filling important staff positions in this period where her term officially ended, but she was still there. So I had a lot of positions, high level positions to fill. A deputy and a couple of assistant directors. But I didn't fire anybody, although there were some pressure from Republicans to get rid of some people they regarded as biased. But I thought it very important to maintain a fairly stable organization.

02-00:45:29

Sharma:

Did you find that relations were different with regard to the Senate and the House, or is it hard to generalize about this?

02-00:45:42

Penner:

Well, they were. Well, that's complicated. In very broad, general terms, because I was more pessimistic, or I would like to say more realistic, in forecasting than the Reagan administration. The Democratic House liked that, obviously. They could beat Reagan's forecasts over the head with our forecasts. The Senate was less enthusiastic, even though I think, ultimately, they knew we were right. But they were rather Republican.

02-00:46:22

Sharma:

They were, yeah. In a tough spot.

02-00:46:25

Penner:

I don't think the traditional Republicans remember Bob Michel was a Republican leader at that time, who was as traditional a Republican as one could imagine. So he had this little rebel group of supply-siders he had to contend with, and they were always very angry with us. But in a way, they kind of appointed Connie Mack to be a watchdog over CBO, and he would come and visit me from time to time. I had a very good relationship with him, and I think, down deeply, shared my concern over deficits, and was not as vigorous a tax cutter as Kemp or some of the others. But he was clearly in that general group of rebels, if you want to call them that. Even Jack Kemp, he loved to debate. He was a very charming, good fellow. He never was vindictive in his complaints against me. We could always have a good discussion.

02-00:47:56

Sharma:

In fact, that would probably be one of the rare occasions where you'd have a chance to deal, substantively, with a representative.

With the time that we have left, I want to just get some of your thoughts on broader points. I think you've written quite persuasively in your book, *Broken Purse Strings*, about the fact that it's budget policy, not the process, that is necessarily broken. In other words, its politicians and voters, by extension, that simply don't want tax increases or spending cuts. And this, not the process itself, is the root of our deficit problem. Can you extrapolate a little bit about this?

02-00:48:39

Penner:

I think that was true when I wrote that with Alan Abramson. Now, I would say the process is broken. Very clearly.

02-00:48:49

Sharma:

How so?

02-00:48:50

Penner:

Well, they couldn't pass a budget last year. For the first time in the history of the budget process, the House couldn't pass on it. I know the Senate hasn't-time to time, and from time to time, they'd pass different ones, and not agree in conference. But at least somebody passed one. Nobody passed one this

year. This is the first year in my memory, and I think maybe the first year in history, although you can check this, that no appropriations bills were passed before the beginning of the fiscal year. They floundered, they let the estate tax expire as if by accident. They floundered and floundered over the [George Walker] Bush tax cuts. Here it is, December of 2010, we don't know for sure what tax bill we'll owe for 2010. They haven't settled the AMT [alternative minimum tax] for 2010, the tax, the research and expenditure tax credit. They're totally dysfunctional, in my view, in terms of fiscal matters right now.

02-00:49:49
Sharma:

To what do you attribute this?

02-00:49:53
Penner:

That is more difficult. I think partly, it's simply because the deficit is so bad. It's very obvious they didn't want to pass a budget resolution because the Democrats didn't want to have to vote for the five year kind of deficit projections they would have had to put in it.

02-00:50:17
Sharma:

They would take heat for that.

02-00:50:18
Penner:

Yeah. They would have to essentially approve these gargantuan deficits relative to anything in our history. So that may be the main thing. But to some degree, the budget process is itself at fault. Going back, what the budget process does, in general terms, is create a huge incentive to make all these tax provisions and other provisions temporary, because then you don't have to show their debt. The big advantage of the budget process that all us academics liked when it was invented was that it forced them to make five-year projections of the results of their decisions. Well, they found a way around that.

02-00:51:19
Sharma:

Ah, by just doing temporary cuts.

02-00:51:21
Penner:

By doing temporary things. It's gotten to the absurd, where they have the doctors' fix now until January 1 that they just passed.

02-00:51:28
Sharma:

This is specifically done to avoid pessimistic deficit projections?

02-00:51:33
Penner:

Yeah. It's even worse when you have PAYGO working, because they only have to pay for it one year at a time, instead of having to pay for it for a five-year period. I think all this really encourages them to do all this temporary stuff. But when you have all this temporary stuff, you've got to devote time to renewing it every year, and that's becoming a huge task. I don't know how many temporary tax provisions we have now, but I think it's in the order of a hundred or so. Of course, the Bush tax cuts too, that was a little more

complicated. That was the result of reconciliation. Well, partly the result of reconciliation, where the Byrd rule wouldn't let him extend it beyond—

02-00:52:28

Sharma: 2010. Or 2012, sorry.

02-00:52:32

Penner: Actually, the Byrd rule would have let him do it through 2011, but for other reasons, they limited it. If they hadn't been temporary, the debate now would be totally different. So I think that's part of it. Part of it is the poisonous partisanship that has grown up, and that has a lot to do with how we draw district lines. Very frankly, I'm a great believer in the role of personalities in history, and people aren't behaving like adults. People like Howard Baker and Bob Dole and Danny Rostenkowski and Tip O'Neil, to some degree, were superb legislators. I talk about extreme partisanship, but you couldn't think of a more extreme partisan than Tip O'Neil. But he wanted to get things done. One of my favorite examples is the '83 Social Security reform. He and Reagan had a secret agreement that they would not oppose what the Greenspan commission came up with. Could you imagine that kind of deal with Pelosi and Obama, the same party? That they would not oppose, say, the fiscal commission's—you just can't think of that today. Moreover, you couldn't keep it secret, I suppose, like Reagan and O'Neil did for quite a long time. But Greenspan will tell you that, without that agreement, they wouldn't have gotten anywhere.

So the world is a different place, in part, because of the personalities, I think.

02-00:54:30

Sharma: I see. I'm going to turn it over to my colleague, Martin. Do you have any follow-up questions?

02-00:54:56

Meeker: Actually, I just have one question. It's just a one question, and it's asking you to follow up on something that you alluded to, and I'm wondering if you can draw it out a little bit. And it's about the disintegration of Gramm-Rudman-Hollings. You attributed this partly to some work done by Richard Darman when he was, I guess, at that point, OMB director. Can you describe what it was that Darman did that sort of facilitated the transformation, if you will, of Gramm-Rudman to the Budget Enforcement Act?

02-00:55:14

Penner: Well, I thought he played it like a violin concerto. First, in January of 1990, put an enormously optimistic forecast on the street which implied you didn't have to worry about Gramm-Rudman being fulfilled. It was a really pretty ludicrous forecast. Then in March, he suddenly said, whoops, our forecast is far too optimistic. And he came back with a very pessimistic forecast, which essentially made Gramm-Rudman impossible to operate. The sequester would have been gargantuan. So he kind of hit him with a one-two punch, so to

speak. He made him happy for a while, and then really hit him hard with this. He was desperate to get some sort of deficit reduction deal. Also, I think, I don't know this for a fact, but I think desperate to find some way around [George Herbert Walker] Bush's "read my lips," no tax increase pledge. I think he manipulated both the Congress and the president at this 1990.

02-00:56:42

Sharma:

The story about the incoming Clinton administration getting these negative forecasts from Darman at the last minute, sort of sound somewhat similar, I guess.

02-00:56:52

Penner:

I don't remember that, actually.

02-00:56:54

Sharma:

There's this—it could be myth—about the incoming Clinton administration embracing deficit reduction, in large part because right in during the transition, Darman came to them with really negative deficit projections. Now, this is sort of questionable, since the CBO had already put out quite negative projections of the deficit, but nevertheless, is considered part of the reason why Clinton embraced deficit reduction as a primary goal.

02-00:57:24

Penner:

It's a curious phenomenon that the outgoing administration is responsible for the budget for the—right? The Bush administration didn't do anything. We, in the Ford administration, used that opportunity to put forth a philosophical document that stated our values with regard to budgeting and deficits and so forth. And actually, I think it was a pretty good document, though given it was lame duck, nobody read it.

02-00:57:58

Sharma:

So it would have been the fiscal '77—

02-00:58:01

Penner:

It would have been fiscal—yeah, is that right? No, fiscal '78. That was the time of the transition quarter. Remember—

02-00:58:12

Sharma:

Oh, this one—yeah.

02-00:58:14

Penner:

We were going to give the Congress lots of time to do their appropriations before the fiscal year began. That didn't work out so well.

02-00:58:22

Sharma:

That about covers it. We've taken up two hours already, so I think—love to maybe.

02-00:58:31

Meeker:

Final statements?

02-00:58:31

Sharma:

Yeah, do you have any final statements? One of the things that we've been asking people is helping us to periodize our study. We're starting our investigation in the early seventies, and sort of treating this, especially the 1974 Budget Act, to the present day as a distinct period with regards to budgetary matters. But I think there's an argument to be made, and I think you've sort of spoken about it, that the current situation is really a product of events since the Clinton surpluses of the late 1990s. So what we find ourselves in now is something that's really developed over the last ten years.

02-00:59:17

Penner:

That's true. With the last couple of years being crucially important in all of this. The crash and the stimulus program took the debt issue from being just a problem to being a matter of enormous concern now, as we jump from a debt of, depending on when you start, about 40 percent of GDP to now over 60 and growing fast. So it's a whole different world in terms of the urgency of doing something about the situation.

02-00:59:55

Sharma:

Well, I think that's about all. Thank you so—

[End of Interview]