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Audio File 2

Critique of Republican approach to fiscal policy—Notion of an investment budget—Views on 1990 Budget Enforcement Act
This is Patrick Sharma on November 16, 2010 with former Labor Secretary Robert Reich. Secretary Reich, I’d like to start just briefly talking about your years before you entered the Clinton Administration. How did you become interested in questions of political economy?

Well, I suppose it goes back to college. I got very involved in the Civil Rights Movement and then anti-Vietnam War activities. I had been an intern in the summer of 1967 for Robert Kennedy. I, in 1968, was part of the Eugene McCarthy for President campaign. So there was no question that I had a certain responsibility to be engaged in public policy from those years. That everybody did. It wasn’t just me.

And then I was fortunate enough to get a Rhodes Scholarship. I studied economics and politics then went to Yale Law School because that was, at that time, the place you went if you wanted to be engaged in public issues. Bill Clinton was there. Hilary Rodham was there. Clarence Thomas was there. We were all in the same classes together. Then I clerked for a judge, then went to the Justice Department. I spent a couple of years briefing and arguing Supreme Court cases. Then I went to the Federal Trade Commission as director of the policy planning staff and then spent the next twelve years teaching and writing about public policy at the Kennedy School until Bill Clinton asked me to head his economic transition team in 1992, right after he was elected President.

And during this period, if you can describe for us your thinking about budget deficits. Whether you thought about that, how you thought about that, whether or not those views changed over time?

I was never terribly concerned about budget deficits. My father, who, when I was a young man—in fact, when I was a kid my father was a Republican didn’t like what had happened to the economy under Roosevelt and Truman. I remember conversations when I was about five, so it must have been under the Eisenhower Administration, that the debt that Franklin D. Roosevelt had created would be on my shoulders. I’d have to pay it back. My children would have to pay it back. My children’s children would have to pay it back. He scared the dickens out of me. But, remarkably, by the late fifties no one was talking about FDR’s debt. The Cold War was still going on. We had had a Korean War. It wasn’t that military expenditures or even federal government
expenditures had dropped that significantly but economic growth had changed the equation so that the Roosevelt debt was much smaller as a proportion of total national income. The lesson I took from that, and it wasn’t a literal lesson because I wasn’t sophisticated in economics, is that my father had been wrong. Then, everything seemed to be quite prosperous. Even though we, as a family, were very middle class. But they were prosperous times. I stopped worrying about budget deficits and public debt.

Sharma: And even thought you weren’t necessarily engaged within the academic economics profession, did you see this relative lack of concern with budget deficits being a common feature in public thought?

Reich: Even when I began to engage with public policy in the sixties, Lyndon Johnson then was embarking upon both the Great Society and starting to escalate the war in Vietnam. The apparent consequence was not a budget deficit so much as inflation. It was clear that the country couldn’t afford to do both the Great Society and mount a hugely expensive war in Vietnam. But there was very little discussion about budget deficits. There was a lot of discussion about inflation.

Sharma: And at the time, especially during the 1970s and 1980s, did you notice things changing? That is, people becoming more concerned about the effect of budget deficits on economic growth or inflation?

Reich: Well, remember, Richard Nixon had purportedly said, although he didn’t actually say this, but this was what was reported, that we’re all Keynesians now. Keynesian economics was the dominant framework for understanding national macroeconomic policy through the sixties right up through the 1970s. So that budget deficits were accepted as a necessary and inevitable part of public policy. You had to have some deficit to maintain balance in the economy, otherwise there would be a potential problem of recession or deflation or inadequate demand. The only time anybody worried about inflation was a brief period in the late 1960s. The dominant concern coming out of the Second World War—indeed, coming out of the Depression—was inadequate aggregate demand. That began to change in the 1970s. The Arab Oil Embargo created a great deal of concern, real concern, justifiable concern about inflation. But that was not so much inflation powered by deficits or excessive government spending. That was inflation powered by oil prices that soared.
Nonetheless, the dominant economic paradigm began shifting and by the time Ronald Reagan, Margaret Thatcher, the new regime of economic thinking took over in the 1980s, it wasn’t any longer Keynesian concern with inadequate aggregate demand that dominated public discussion. It was supply side discussions of how to generate economic growth and avoid inflation.

Sharma: Let’s get back to your time in the Clinton Administration. I’d like to start with your role in the campaign itself, if you can remember back to those years. Now you, as far as I know, were head of the economic policy team during the campaign.

Reich: Not during the campaign. There was not, to the best of my memory, an official economic team with an official head. There were about five or six of us who advised Bill Clinton. We all talked with him, sometimes formally, sometimes informally. It wasn’t until he was elected that he actually created a formal economic team. And I think maybe a day or two after he was elected he called me at my office at Harvard and asked me if I would head it up. And I went to Little Rock, Arkansas and began working with Gene Sperling, who had been in the campaign working on economic matters. Not as an outside advisor but as an inside staffer. I was the head of the economic transition team. Gene was my deputy, and I both organized, or tried to organize, the advisors who had been with the President through the campaign and bring in a few additional ones.

Sharma: Can you help us get a sense of what the content of candidate Clinton and then President-Elect Clinton’s economic thinking was? I know there’s this idea of the investment revolution of which you were a major proponent.

Reich: Well, I would like to think, modesty aside, that he was influenced by a book I wrote called *The Work of Nations*, which made a simple but I think important, even today, proposition. Which is that in a global economy, in a rapidly globalizing economy, the only assets a nation has that are truly national, that are not footloose, are its people and the infrastructure linking its people together. So that investments, public investments in education and infrastructure is critical in terms of attracting global capital to create high wage jobs. Rather than obsess about crowding out of private investment, a global economy, by its very nature, does not have a shortage of private investment that will be crowded out by any individual government’s public spending. The real contest is to attract private capital and do so not by taking the low wage, low tax, low regulation route. That is a route that will lead inevitably to a lower standard of living if that’s how you attract global capital.
The way to attract global capital is to take the high road, which essentially says, “Global capital, come here because we are so productive. Our productivity, combined with your money, will generate high returns for you and for us.” By contrast, the low route says, “Come here because we’re so cheap. Our low costs combined with your capital will generate a high return for you and a little bit of return for us.” Well, you can’t win on the low road. Bill Clinton agreed with those principles and his economic plan, Putting People First, we called it, was centered on public investments. And the central public investments were education and infrastructure.

Sharma: Right. Now, I think this is one of the most interesting chapters of the Clinton Administration. The move from this initial vision of government directed public investments in human capital to gradual embrace of deficit reduction as arguably the primary economic goal. I’d really like to get your thoughts about how you saw that process unfolding, whether that was something you anticipated, whether it took place during the transition period.

Reich: Well, I began to get wind of the fact that the first George Bush budget deficit was much larger than had been publicly announced when I had a meeting with Bush’s OMB Director, Dick Darman. And Darman showed me the numbers and they were much larger. Not hugely but they were significantly larger than we had assumed. I had to break the news to the President-Elect, who didn’t seem terribly downcast by it. In fact, he seemed charged up. He said, “Well, this is going to be quite a challenge.” At that time I didn’t think that it meant sacrificing the investment goals that he had established during the campaign. But I put together the economic team. I had the largest proponent of public investment other than me, a fellow named Ira Magaziner, make the case for deficit reduction on the perverse notion that I would match people with the opposite view that they actually held. I had the biggest deficit hawk on the team, a person I had brought in to the team who had not been advising Clinton during the election, named Larry Summers, take the opposite position. Make the case for public investment. Parenthetically, I had to do quite a bit of arguing to get Larry onto the team, because Al Gore didn’t trust him. When Larry was the head of economics for the World Bank, chief economist for the World Bank, he had put his name on a paper that argued that the way to deal with toxic refuse in the world was to actually send it to poor countries and have poor countries essentially take it in and take money from rich countries, on the principle that people in poor countries wouldn’t live that long anyway. Al Gore was furious with Larry. So I had quite a selling job to do. But Al Gore finally agreed. And Larry was assigned the case for public investment and Ira was assigned the case for deficit reduction. And we met with the President-Elect a number of times. There was no particular resolution of all of that. During the campaign of 1992, Ross Perot had made something of an
issue about deficit reduction. I thought at the time that he was making too much of an issue of it.

You see, just stepping back for a moment, the recession of 1991-92 continued in 1993 in the form of a kind of “jobless recovery.” That’s not unusual for recessions. It takes time for employers to hire people back. Employers have to be convinced that there is, in fact, a recovery. So during the 1992 campaign, the public was very concerned about the economy. That’s what James Carville’s famous comment, “It’s the economy, Stupid,” came from. And Bill Clinton basically won because George Bush, the first George Bush, had done such a bad job on the economy. What nobody admitted at the time was that George Bush did such a bad job on the economy mainly because Alan Greenspan at the Fed raised interest rates and that caused the economy to go into a recession. And why did Greenspan raise interest rates? Because Greenspan was worried that otherwise the economy was headed toward inflation because the deficits that George Bush, the first George Bush had created, were too large. I give you all that for context.

01-00:17:24
Sharma: Right.

01-00:17:25
Reich: But that also meant that Ross Perot could make budget deficit reduction an issue in the ’92 campaign. Most Americans have no idea what the budget deficit is but when the economy is bad they’re looking for a cause.

01-00:17:41
Sharma: Just sort of exemplified in that question at the Presidential debate, I’m not sure you remember, where that lady asked the candidates, “How has the deficit affected you?” or “Has the national debt effected you?”

01-00:17:57
Reich: Yes. And, again, the simplest analogy that people draw is that the government budget is just like a family budget. And if the government is running deficits, that’s tantamount to a family going into debt, which is bad for a family and so it must be bad for the country. And therefore, if you’re in an economic downturn and a Presidential candidate like Ross Perot starts railing against the deficit, it’s easy for a number of people to begin thinking that the deficit is the problem. But let me hasten to say that when Bill Clinton was elected, although Ross Perot’s deficit mania was still in the air, it was not a major part of Bill Clinton’s thinking. Not until I got the numbers from Darman.

01-00:19:03
Sharma: I see. I’d like to just ask you to clarify this point about Darman. There seems to be some debate about whether Darman’s projections were really surprising,
since I think it was the Congressional Budget Office had a few months prior already released somewhat pessimistic out year forecasts for the deficit. Do you have any recollection of that?

Reich: I think that many of us thought that Darman would have better numbers and that the Bush Administration had not been terribly dour about the budget. And OMB tracks those numbers. Or at least at that time tracked the numbers more carefully and better and had better access to what was really going on than CBO.

Sharma: Than CBO.

Reich: So essentially I assumed that the numbers would look better when I talked with Darman. Also just on this context. When I was head of the economic transition team, I went around to key leaders of Congress and others. Some of them did express anxiety about the budget deficit. Leon Panetta, for example, said that the budget deficit was a huge problem. There were people around like Alice Rivlin, who had been the first head of the Congressional Budget Office, who told me that the budget deficit is a big problem.

Sharma: Right. Deficit hawks.

Reich: They became known as deficit hawks. I don’t think we had the term exactly right then. So there was a group that was particularly concerned about the deficit.

Sharma: And then the ’92 election also brings in a lot of Democratic representatives who are also concerned about the deficit. Is that—

Reich: Yes. They weren’t called Blue Dogs then. But yes. They were conservative Democrats who accepted the emerging conventional view that the deficit was too high. Now, by that time, I know enough and have been around public policy circles enough and had been teaching enough to know that the issue wasn’t the deficit per se. It was the ratio of the deficit to the GDP. I was pretty confident that once we came out of the recession, if we had a healthy recovery, the deficit GDP ratio or the debt GDP ratio would start declining. So I personally was not concerned about it.
And during the transition do you think that that was the majority position? That most of the economic policy advising team wasn’t overly concerned about—

I would say it was a mixed bag. Bob Rubin was concerned. Not as concerned as he subsequently expressed. Larry Summers was concerned. Roger Altman was concerned. I was not. Laura Tyson wasn’t particularly concerned. Gene Sperling was not concerned. George Stephanopoulous, not an economic advisor but a political economist advisor, was not concerned.

Was there any sense that, as what happened, the investments would get so stripped from Clinton’s agenda and that deficit reduction would really emerge as such a priority?

Not then, not then. It wasn’t until January of 1993 when we began to actually go through the next year’s budget and face the reality, we had to come up with a budget for Congress very, very quickly, that we began getting into arguments. Not unfriendly arguments but strong arguments about how much deficit reduction was necessary. Beginning in late 1992 and the start of 1993, if you want to call them the deficit hawks, began pushing harder. And I’ll be perfectly candid with you. I pushed back as hard as I could, both because I didn’t think the deficit would be that large a problem but also because Clinton’s promise to cut the deficit by half, which he had made during the campaign, it seemed to me was only meaningful in terms of cutting it from five percent down to 2.5% of GDP.

GDP.

GDP. Not cutting it literally in half.

Of course. Right.

In other words, the ratio is the issue.

So you were focused on increasing GDP to the ratio.
So it seemed to me that the focus should be on increasing the GDP and if we
shrunk the deficit from five to 2.5% GDP but we had healthy GDP growth, we
didn’t have to sacrifice much by way of the public investment agenda. The
public investment agenda itself would speed economic growth.

And therein lay the difference within the Clinton Administration.

Yes. It was a key difference. Lloyd Bentsen came in as Treasury Secretary. He
was also a deficit hawk. So you had Bob Rubin, who by that time had become
head of the National Economic Council. We created this National Economic
Council. Bob was supposed to be an honest broker and tell the President,
express just the different views. Lloyd Bentsen was Treasury Secretary and
was a confirmed deficit hawk. He had been senator. And then Leon Panetta
was at OMB. So you’ve got those three and Leon is a deputy then. I think his
first deputy was Alice Rivlin.

So all four of them came out clearly as deficit hawks and there weren’t too
many on my side. Bill Clinton resisted them at first but he got worn down.
George Stephanopoulos and I both made the pitch that he should not reduce
the deficit by half. He should reduce the deficit from five percent of GDP to
2.5% of GDP and we were coming out of a recession and that meant he didn’t
have to make the kind of cuts in planned investments.

But there’s another actor who comes in here and that was Alan Greenspan.
Alan Greenspan, at that time was like, what do you call it, one of the stars that
are a—a black hole. That’s right. A black hole in space. I could only tell of his
existence by the movement of other celestial bodies in his direction because as
chairman of the Fed he had to be quite discreet and quite quiet. But he was the
biggest deficit hawk of all and he was telling Lloyd Bentsen in no uncertain
terms that the deficit had to be reduced or else the Fed would not reduce short-
term interest rates. I believe, although I don’t have any direct evidence.
Greenspan alludes to this in his auto-biography, his memoirs, that he was
telling the President directly. It was almost as if he held a gun to the
President’s head. The minute I began understanding this, the whole thing
made sense to me. What Greenspan essentially was doing was saying to
Clinton, “Unless you reduce the deficit dramatically, I will not reduce short-
term interest rates. And unless I reduce short-term interest rates, we’re not
going to have a buoyant recovery and you may not get reelected.” That was the threat. Well, the rest is history.

Sharma: Right. Nevertheless, despite this elevation of deficit reduction and the pressures on President Clinton, he does present a fairly robust first budget with regards to public investments. You guys did ask for a fairly significant public investment budget and it ended up getting stripped down, largely, as you write in your memoirs, by Democrats in Congress who shared these deficit reduction concerns. Can you give us a sense of how you saw that unfolding, whether you anticipated the Democratic opposition to—

Reich: I knew that the Democratic opposition was there. I had talked with many Democrats during the economic transition. Many of them, like Leon Panetta, had expressed worry about the growing deficit. They, in turn, were affected by their constituents. Their constituents who, in a jobless recovery, in a recession and the jobless recovery, were convinced or had been told that the budget deficit was responsible for the bad economy.

And then I’m sure Lloyd Bentsen and also Leon Panetta didn’t exactly help. I think that their concerns about the budget deficit must have made it more difficult for them to robustly sell the President’s investment agenda to Congress when they themselves shared many of the same concerns that members of Congress shared.

Well, let me just say that first budget was as good as we could do, but it still represented less than the President had proposed and less than we had wanted. It still represented a lot of compromise. And then yes. And then Congress fought back.

Sharma: I see. And during this period, did you think that Bill Clinton also was held back in lobbying for his budget or he sort of started to share some of the deficit reduction concerns?

Reich: I think that he began to worry a bit about Greenspan. His first reaction was, “Look, I didn’t get elected to be a bond trader on Wall Street.” And he was angry or at least expressed anger about having to propose a budget that was nowhere near as large as his investment budget was going to be. And then expressed anger about having to whittle it back further. But then he seemed to accept the inevitable. I think that was probably Greenspan’s influence.
Sharma: I see. There’s an interesting chapter in the early Clinton Administration where, I forget who exactly it was, came to Clinton and told him that some of the proposed spending increases that he had proposed—I think it was in the first budget—ran afoul of discretionary spending caps that had been instituted in 1990 under the Budget Enforcement Act and Clinton was surprised that he hadn’t been told this and it was really a failure on the part of Leon Panetta and Alice Rivlin to walk him through the complexities of the federal budget process. What exactly do you remember about that?

Reich: Well, I remember how upset Clinton was being told this so late in the game. And I remember being perplexed about why Leon and Alice, who obviously knew this, had not revealed this earlier. We had spent weeks and weeks in the White House going through budget numbers and trying to squeeze the budget down. But this particular point had never come up.

Sharma: There’s a larger question I want to ask about President Clinton and the Clinton Administration’s rhetorical strategy during these early years. In your memoir you write that President Clinton struggled to explain why fiscal stimulus and public investment was consistent with the larger objective of reducing the deficit. I wonder if you could speak a little to that and whether you see that as a flaw in Bill Clinton’s Presidency or the fact that he was maybe captive to a larger, more conservative discourse about fiscal policy.

Reich: Well, he fell into the same trap that many Democratic Presidents fall into. Obama is the same. That is, accepting the frame of reference that Republicans want to impose and conservative Democrats: the biggest issue is the deficit. Not economic growth but the deficit, and that somehow public spending is anathema to economic growth. In other words, it’s as if they’re looking through the wrong end of the telescope. What I had always argued, and still argue, is that if your real concern is the ratio of deficit or debt to GDP and you believe that a stimulus and/or public investments are critical to economic growth, then you start from the other end. It always seemed peculiar to adopt the frame of reference that the other side was using. The public doesn’t know what a deficit is. Debt and deficit become meaningful, as I said before, only by reference to an analogy with the family budget. But the public doesn’t know numbers. It doesn’t really follow what the numbers are. The media columnists and others who are translating public policy are the ones who really can either frame it one way or the other way. And I remember watching in 1992, 1993 how the so-called responsible media, the kind of eat your spinach media, began looking through the other end of the telescope. That the deficit is the biggest issue.
Sharma: And why do you think that was?

Reich: Well, I think it partly reflected the fact that this was the first Democratic Administration in twelve years and the Democrats have to prove their credibility to a larger extent than Republicans do on the issue of spending and deficits. That’s also true of Wall Street. Wall Street was much more tolerant of George Bush and his deficits, as was the Federal Reserve Board and Alan Greenspan. But when the Democrats took over, suddenly Wall Street started hollering about deficits, as did Alan Greenspan. I think it’s an asymmetry that’s built into the political system. And may be a legacy of FDR and LBJ.

Sharma: I see. So in your memoir you write quoting Marty Sabo about a sort of conspiracy of silence when Reagan and Bush were Presidents and deficits bloomed. That businesses were getting what they wanted and it wasn’t negatively impacting them. Is that what you would say happened?

Reich: Exactly. And you can see it again with regards to George W. Bush and Barack Obama. You have almost the same phenomena.

Sharma: It’s interesting to think about, because ostensibly concerns about budget deficits would include increasing taxes. Businesses who are concerned with reducing their tax burden wouldn’t necessarily want to raise concerns about the deficit. In the fiscal equation, spending and revenues, do you think that we’ve reached a point, or at least how you see this unfolding over time, where the discourse about reducing the deficit is focused only on reducing spending? In other words, raising taxes are completely off the table.

Reich: Well, and that’s partly because since the late seventies the median family income has barely risen, adjusted for inflation. So there’s certainly no capacity and no eagerness on the part of the middle class to have their taxes increased. But simultaneously you have the development of a very powerful political machine supporting wealthy taxpayers that says, in effect, their taxes have to be kept low in order to keep them adequately engaged in job creation. This is the supply side nonsense. If you combine the two, that is, the flattening of the median wage and the increasing political power of the top to frame the debate about taxes, then you really only get spending cuts coming out of the cut the deficit discussion. This was understood by Ronald Reagan and David Stockman when they talked about starving the beast. They were going to spend a lot. Reagan’s years were classic military Keynesianism.
Sharma: Yeah, that’s true.

Reich: And he admitted as such. Stockman and Reagan and then the first George Bush were going to create huge budget deficits in order to put Democrats in an impossible position, so the Democrats like Bill Clinton, by the time they came along, would have a very difficult time selling the public on additional spending.

Sharma: Additional spending and/or tax increases.

Reich: Well, and again, tax increases, remember, had because of the flattening of the median wage and because of the efficacy of people at the top, been shelved. The top marginal tax rate in the 1950s was ninety-one percent. Under JFK it went down to seventy-six percent. But by the time of the Reagan Administration and then Bush and then Clinton, the debate is over, what, whether it’s going to be thirty-six percent—

Sharma: Thirty-six percent.

Reich: —or thirty nine percent. We’re not close to the top marginal tax rates that were considered necessary and common between the late thirties and, well, really right up to the seventies.

Sharma: Right, right. So while we’re on the subject of revenues, I think one of the most important legacies of Clinton’s first budget were the tax increases that were contained in it. How did those come about, specifically the increase in marginal tax rates for the top earners?

Reich: Well, there was no other way to do it. The political people were very involved in that discussion and the economic people, obviously. We had squeezed the investments down to what we could. Discretionary spending, domestic discretionary spending was really rather small as a portion of the total budget and so there was just nothing left. Bill Clinton wanted to be able to show that he had at least some investments left in the pipeline. The tax increase was modest. It was not a huge tax increase. I think what we should have done was
have a BTU tax, a carbon tax. And that was debated. And Al Gore was against it.

Sharma: Al Gore was against the BTU tax?

Reich: Yes.

Sharma: Oh, I was under the opposite impression. That he was—

Reich: He was against it.

Sharma: How do you reconcile that with his concern about—

Reich: I didn’t understand it at the time but I began to understand it. I think he went into the Vice-Presidency hoping to become President and he had hanging over his head the image of a tree hugger that he didn’t want to have to defend.

Sharma: I see. Interesting. Okay. And, of course, the tradeoff was a higher gasoline tax, right, because that was considered too much. Just while we’re still on the subject of the first budget. Of course, Clinton also cut defense spending. We can debate whether it’s fairly significantly or not. But he did cut defense spending as part of this drive to reduce the budget deficit. Do you remember at the time any significant discussions about reducing the entitlement spending that was taking up a growing portion of the pie?

Reich: A little bit. But realistically, Social Security was not going to be cut. Nobody wanted to get near Social Security. It’s a sacred cow. It is today. And it was not the big problem. Medicare was starting to rise but nowhere near the extent to which it subsequently rose. And Medicaid was also beginning to rise. But taking on the entitlements was just thought of as too much.

Sharma: I see. Okay. So there might—
Reich: And remember, Bill Clinton was working on a health care plan and the assumption and hope was that that health care plan would deal with rising health care costs and also temper the rise of Medicare spending.

Sharma: As the '93 budget worked its way through that first year in the Clinton Administration, did you have a sense that the public investment program was really going to be significantly scaled back and this was sort of lost at this point?

Reich: I did. I felt like the whole reason that Bill Clinton was elected, and the intellectual and policy structure on which he based his election, was being taken apart. I think fundamentally part of the problem was an inability to distinguish between cyclical and structural changes in the economy. Even if it weren’t for the inevitable presence of the ’96 election and the desire to have Alan Greenspan cut short-term interest rates so the economy would boom, I think that Bill Clinton lost sight of the fact that his investment agenda was really about the long-term. It was about the structural changes in the economy. You want to invest in education, in infrastructure, not simply because of its stimulative effect in getting the economy back, but really more fundamentally because it builds the productive capacity of the middle class and the working class. And that transcends the business cycle. But the problem is that for any president, your life is the business cycle. The long-term doesn’t exist.

Sharma: Right. Although ostensibly it’s a very valid and politically appealing case to make. Wonder why these long-term investments in the economy are both good short-term and long-term.

Reich: Yes. But once the economy is back on track, once there’s adequate stimulus in the economy, it’s very hard then, particularly if you’re facing deficits, to make the case that this is still important. Stare down the Federal Reserve. Stare down the conservative Democrats and the deficit hawks. Hold your ground against the Republicans. The only way we build the productive capacity of this country is through basic R&D and infrastructure and education and job training and if you don’t do all of this over the long-term, we are going to see a big portion of our population losing ground and losing its standard of living. But that will be ten years from now or fifteen years from now.

Sharma: It proved difficult even in an era of surplus and when people want that returned in taxes.
Yes. I think the most shocking thing to me was that once we balanced the budget a year ahead of the Congressional agreement—and by the way, the Republicans, of course, and Gingrich, height of hypocrisy, they had never complained about budget deficits when they were in power. But it gave them some purchase over Bill Clinton and they wanted to get Peronistas and all the others on their side. But the height of hypocrisy for them to demand the budget deficit be eliminated and the budget be balanced. But the economy was so strong. The recovery was so strong. Alan Greenspan had put interest rates down and had been willing to accept a new natural rate of unemployment. Not six percent but actually closer to four percent. That is the non-inflationary rate of unemployment. Which meant that the Fed led the way toward a very, very vigorous recovery, which in turn meant that the budget was balanced a year earlier than law required. But even then, I expected Bill Clinton to say, “Okay, now that we’ve balanced the budget, now we can turn back to our investment agenda.” But you see, by then it was too late. The frame of reference had shifted already. The public no longer believed in the investment agenda. He had not really talked about the investment agenda. By the ’96 election, he said nothing about it. It was all V-chips and school uniforms. Dick Morris was completely in control. So that the predicate had not been established. The public had not been reminded of the importance of the investment agenda and therefore by his second term, as the surpluses mounted, his major concern was to prevent the Republicans from taking all those surpluses and simply saying that they should be used for a tax cut.

So he, by the late nineties, Bill Clinton was saying put Social Security first. The investments had disappeared entirely by that time. Put Social Security first was his way of essentially saying to the public, “If you don’t use this money, these surpluses, to create a Social Security trust fund or to in any way boost the Social Security trust fund, a lock box trust fund—“well, that was actually Gore—“Social Security is going to be jeopardized. Of course it wasn’t. Social Security wasn’t really in trouble. And then to make it really absurd, Al Gore in 2000, in the election, when we had enough money from the surpluses to save Social Security by any stretch o the imagination, Al Gore went the next step and said, “What we really ought to do is reduce the debt.” Where did the investment agenda go? It completely evaporated. It no longer was even something that the public understood or accepted or a politician could appeal to.

Before moving on to the late nineties, as this process unfolded in 1994 and then you see the Republican takeover of Congress in 1995. Among Clinton’s economic advisors, was there frustration at this? Can you just give a sense of—
Reich: At the lack of—

Sharma: At the lack of—

Reich: At the deficit? Oh, you mean the investment—

Sharma: Well, the overriding focus on deficit reduction and the lack of focus on—

Reich: Oh, it depends on who you’re looking at, I would say. I think that the Rubin, Summers, Panetta, Bentsen wing felt, well, this was inevitable and necessary and the investments were probably bullshit to begin with. In fact, I think I had discussions with Lloyd Bentsen to the effect that those investments, they were just baloney.

Sharma: Help us get a sense of what the thinking was. I understand the Rubinomics argument that, okay, government spending will crowd out private investment and drive up interest rates. But was there also a sense that the government wasn’t capable of actually undertaking public investments? That these were just—

Reich: Some of them, I’m sure, and you’d have to talk to them, were skeptical of the public sector’s ability to do it. And I would have discussions with many of them about, number one, how you can’t really have crowding out in a global economy because it’s a global capital market and number two, that if the public sector did not do these investments, who’s going to do them? That there’s no incentive in the private sector to make public investments in education, infrastructure, basic R&D by the very nature of the impossibility of appropriating them in a way. But I got absolutely no where. I think it wasn’t because they were being intellectually dishonest. I think they just simply felt that, A, crowding out was a real phenomenon and B, the public sector either couldn’t do it or shouldn’t do it.

Sharma: And you didn’t see these particular views changing over time? Bentsen’s views stayed the same? Everyone’s views stayed more or less the same?
Reich: If anything, they hardened.

Sharma: So people are policy, I suppose.

Reich: People are policy. Yes.

Sharma: People are policy. With that in mind, how do you think Bill Clinton went about staffing his cabinet and choosing his economic advisors?

Reich: Well, that’s a good question. I think he wanted somebody at OMB like Leon who knew the budget. Leon had been on the Hill. I think head of the budget committee. So he knew it inside and out. He wanted somebody at the Treasury who would be respected by Wall Street and he wanted someone who also was very respected in the Senate. So Lloyd Bentsen had been head of the Senate Finance Committee and Alice had distinguished herself at the Congressional Budget Office. These are all extremely bright people. Bob Rubin, he wanted somebody who worked well with others, was well connected. I never had any personal frictions with any of them. I thought they were very good people to work with. But we saw the world differently.

Sharma: I see. And among Clinton’s economic advisors, who would you say was allied towards your views? Would that be Laura—

Reich: Well, I think Laura Tyson was probably closest to my views and then the political advisors were, up to a point, closely aligned with my views. And I think Clinton himself. He came in absolutely sold on, again, let me just say, modesty aside, because I know that he was very influenced by The Work of Nations. I think he was sold on these arguments.

Sharma: I don’t know how much time we have or you have. We could go on.

Reich: I’ve got to head back at about four o’clock.

Sharma: I’d like to ask you a little bit about—
Meeker: There’s like five minutes left on the tape. And actually, can you be careful about the mic.

Reich: Yeah.

Sharma: Well, with what limited time we have left, just ask you a little bit—love to get more time if you have it in the future. But about your particular role at the Labor Department and whether the growing concern with reducing the budget impacted your work at the Labor Department?

Reich: In two ways. First of all, because I was on the National Economic Council. One reason I took the Labor Department job was because we had organized the National Economic Council so that the Secretary of Labor was a permanent principle member of the National Economic Council. So I had two hats, in other words. And I spent a considerable amount of time at the White House on these issues.

But I also took the Labor Department job because I was concerned about the American workforce and I thought maybe I could actually work more intensively. It did impact us in terms of job training quite considerably. The American economy had been starting to go through huge changes in the seventies and continued in the eighties and by the 1990s it was evident there were gigantic mismatches between what people were educated to do, or the skills they didn’t have, and what was needed in the workforce. I worked hard with Ted Kennedy and Nancy Kassenbaum to create a new Workforce Development System that would better match skill training with jobs. But there was no money for it. Simply no money. Another example. Unemployment insurance. We wanted to establish a system by which workers could be profiled immediately upon losing their jobs and go into the training if they were unlikely to get their old jobs back again. And by the same token, a system that would give them essentially one door through which they needed to go to get every program that was possibly available. This was not lots of money. We could do this for a billion. Now, one billion dollars sounds like a lot of money but in the federal budget a billion is a drop. And I remember going to Clinton and saying, “Just, please, a billion dollars. Just an additional billion.” Then he said that I’d have to take it up with Rostenkowski, who at that time was Senate Chair of the relevant appropriation committee. I went to Rostenkowski. I said, “I need a billion, just a billion.” It became impossible to do much of anything because every dollar became a contest. Dick Riley was a good friend of mine as Secretary of Education and he had some very
important programs. Labor and Education were battling over—not literally battling—but the question was who gets this last dollar. It should never—

Sharma: Of these discretionary spending amounts.

Reich: Of the discretionary spending. It was down to a trickle.

Sharma: I see. Do you think that’s a common experience over Presidential administrations? When people are looking to cut budgets, they single out new, relatively modest programs for elimination? Or its staff is sort of—

Reich: Well, they either single it for elimination or they don’t even begin them to start. The Education Department is always on the chopping block, particularly since Newt Gingrich and his Republican—and it’s now on the chopping block again. Department of Labor they don’t dare put on the chopping block because of the power of organized labor. But all of the job training programs, the education programs that organized labor has no real interest in were quite vulnerable.

Sharma: Do you see any particular successes with respect to some of the proactive spending programs that the Labor Department actually undertook? Thinking of the School to Work Act.

Reich: Oh, yeah. The School to Work was important and we did a lot of job training. We had a lot of pilot programs that were very promising. For example, a program for women, poorly educated women in non-traditional women’s occupations like truck driving and pipe fitting. I remember being struck by not only the success rate, the number of women who went through the program and just became pipe fitters and truck drivers. But sitting with many of these women in focus groups and seeing how proud they were, their bodies. Part of the training was body building and their bodies had changed and they were tough. They had gained so much in terms of their views of themselves and their abilities to do things. I went around poor communities all over the country and talked to people whose education basically ended in tenth grade or eleventh grade who had so much to offer. Short-term job training for teenagers didn’t work very well. The data was clear. But a year program in a community college for somebody, where you knew that a job was waiting at the end, was hugely important and hugely beneficial. But there was no money.
Sharma: Well, I’m going to end it there. We’re going to end it there. So this was—

[End Audio File 1]

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Meeker: Your point about crowding out is really interesting and that’s something I think Patrick and I are going to think about a little bit because it’s something we certainly come across in literature. It’s always rung a little sort of peculiar, especially as you mentioned in the context of globalization. So that’s something we’re going to want to think about a little bit more. I kind of want to go back to something that you said at the beginning of the interview when you talked about your father and his concern about the Truman and FDR deficits in the wake of Depression and World War and how his concern ended up being proven to be false over the course of the 1950s and sixties because of the expanding argument. Arguably one of the reasons why not only the expanded economy, but during that period of time, income taxes were not indexed to inflation. So it was incumbent upon Congress to constantly give tax cuts and not have to raise taxes in order to deal with paying off deficits or the national debt, I should say, and trying to keep deficit and surplus in relative equilibrium. Of course, that changes with the arrival of Reagan in 1981 and when they begin to index tax rates to inflation. So you no longer have an opportunity whereby legislators are sort of given the gift of being able to give to their constituents a tax break. Instead, now, there are tax cuts that will eventually have to be compensated for by tax increases, unless you want to have a really expanding deficit, which happens during Reagan’s Presidency. It goes up, what, to like six percent of GDP.

Reich: That’s right. And this is the genius of David Stockman and to the extent that Ronald Reagan understood what he was doing in terms of changing the debate.

Meeker: Knowing that, does that at all kind of influence the way in which you might think about the danger of deficits? Let me put this in another context. There’s a sense, and sometimes it’s called a conspiratorial view but sometimes there’s actually some very good evidence for holding this conspiratorial view. And that is that, particularly the Reagan Administration, people like Stockman and Jim Miller and so forth, were not concerned about federal budget deficits because they actually saw that as a road to delegitimizing the role of federal
government in the image of the American people. That is sort of thinking about the household analogy. That if they ran the federal government into budget deficits, the American people would be less likely to think that the government was capable of running its own business and therefore that would then result in a further shrinking of the federal government. Right?

Reich: Well, it was more the “starve the beast” notion than it was incompetence. The analogy to the family budget didn’t really pick up steam and become vivid to people until Ross Perot. The issue, rather, was—and David Stockman was very explicit about this—that you run up huge deficits so that it’s not possible for subsequent Democratic administration to do much of anything.

Sharma: Which then begs the question of is there not a progressive agenda for addressing budget deficits in order to give the American people the sense that the federal government has its own house in order and therefore it’s possible to begin to attack new things, for instance, like universal health care.

Reich: But only if you accept the “house in order” way of viewing the world. That is, there’s a way of constructing a federal budget that has nothing to do with deficit at all. You have a portion of the budget that has to do with commitments that were made in the past, like Social Security and Medicare and so on. You have a portion of the budget that has to do with future investments, that are judged by their return on investment. That has nothing to do with it. The debt or deficit created or generated by these investments is relevant only in terms of what the return on the investment is. So if you borrow money for early childhood education and you know the return is huge, the social return, then it doesn’t become an issue. And then you have a third part of the budget, which is your current expenditures. It’s neither your past commitments, it’s not your investment budget, it’s your current expenditures. And there you want to roughly balance it because there's no reason, apart from stimulus, apart from macroeconomic policy. So there was no inevitable or logical reason why you have to organize a budget the way we’ve organized our budget. A better way would be to do what a family does. If you’re really going to take the family analogy. A family would never not go into debt to send its children to college. But a family might say, “No, we don’t want to go into debt to take an ocean cruise.” They are fundamentally different things and for the federal government to say, “Okay, we’re not going to repair the roads because we don’t want to borrow the money,” or we don’t want all these kids to go to college because we don’t want to borrow the money becomes ludicrous if you look at the return to the investment.
Meeker: Well, then, thinking about the legislative context, unfortunately there was the limitation of having to operate within a situation that discouraged deficit spending, which was the Budget Enforcement Act and PAYGO rules and so forth. Was there ever any move within the Clinton Administration to perhaps revise that piece of legislation that would have made it easier to, for instance, do some dynamic budgeting when it came to future investments so that they wouldn’t look the same way, perhaps, as year to year budget.

Reich: There was discussion of it. Remember, the Bush Enforcement Act and the PAYGO rules really were fairly recent. In fact, my memory, if it serves me right, Leon and others participated in creating all of that.

Meeker: It was 1990.

Reich: Yeah. So it wasn’t as if these were etched in stone. These were pretty new. What Bill Clinton could have done—not initially because we’re still in the deficit hysteria of the early nineties. But what he could have done once the budget was balanced is come up with a new budget system such as I just created. You call it dynamic budgeting. But there were other ways of doing it. And we talked about it. In fact, he and I talked about it on a number of occasions. I even submitted some memos to him about how it might be done.

Meeker: Can you maybe, just to the best of your memory, give me a sense of what that might have looked like?

Reich: Well, I just said. That is, you divide the budget into three pieces. Past commitments, current expenditures and future investments and each one is treated differently in terms of their fiscal consequences. Past commitments you can’t do anything about. You might be able to grandfather. Say, okay, people who expect it. Then we can trim some of these entitlements. Future investments you judge on the basis of their return as well as you can measure them. That return on investment, if it’s greater than the cost of the deficits that you’re creating, well, it’s a simple accounting analysis. In practice it becomes more complicated. But what you want to do is just the return on investment. If it’s greater than the borrowing cost then obviously you want to do it.

Meeker: Is there any sense why this—
Reich: And then you have a current expenditure which has to be balanced.

Meeker: Is there any sense why this approach never made it into the legislative realm?

Reich: We talked about it. I think the deficit hawks were scared of it, quite frankly. They didn’t believe in it. They thought that stuff would get into the investment budget that shouldn’t be there. Now, what I kept saying is, “No, no, no.” If every item in the investment budget has to be justified by the return being greater than the borrowing costs, obviously we’re not going to know for sure. This is not precise. But at least it will give us a good way of judging. And it’ll be much easier to talk about it in public. You can say, “Look, we’re investing in education and we’re investing in this because the return is much greater than the cost of borrowing.”

Meeker: So I have two more questions. They both relate to the ’92 campaign. The first one was despite many of Bush 41’s foibles, such as his issue with the Japanese Premier and so forth, most people attribute his loss in 1992—one of the main reasons is his reneging on his no new taxes pledge, right, especially this is what many attribute the fleeing of sort of Reagan Republicans to Ross Perot. I wonder what you thought at the time of the use of Bush raising taxes in the campaign to support Clinton’s Presidency. It sort of seems like there’s a double edged sword there for Democrats, for instance, who are perhaps knowing that they will likely have to raise taxes if they want to have their agenda. Do you see what I’m getting at? I’m not saying it very adequately.

Reich: I think you’re over thinking a little bit.

Meeker: Okay, all right.

Reich: The economy trumps everything and what really happened to George Bush is that Alan Greenspan raised interest rates and the economy went into a nose dive. For most people, that’s almost everything. That’s what happened. That’s what Obama’s problem was this past midterm. This is what Jimmy Carter’s problem was with Paul Volker. People don’t think in terms of public policy and they forget who raised taxes and who cut taxes. It’s not on the top of my mind. What they really, really do know is whether they’re able to pay the bills
and whether they’re scared. That’s really what they know. Any analysis beyond that is sort of marginal to the big economic reality.

And the final question is really just inviting you to finish the story that you had started and you didn’t get a chance to tell about giving Ira Magaziner the opportunity to be the deficit hawk and Larry Summers the opportunity to be the investment guru, as we might put it.

Well, there wasn’t much to it. They both came up with position papers. We gave the President-Elect three ring binders and all that stuff. It’s not clear how much he read. He was a voracious reader. He probably read it all but I never had much sense how much he did. I do have to go. We carried on too long. Just one last point about deficits, which is really important, and investments. If you accept my analysis in the global economy there’s no crowding out because capital is moving everywhere. Then the real question is public and private spending versus public and private investing. In other words, the future of a standard of living of people depends on the amount and quality of public and private investment versus public and private spending and consumption. And the way you attract the right kind of private investment is by having highly productive people and a very productive infrastructure in basic R&D. When I wrote about that in ’91, it was more controversial because the globalization had not preceded that far. The global capital markets were not that well developed. It was possible for people to talk about crowding out. Now you don’t hear people talking about crowding out, or at least if they do they’re slightly at the fanatical wing. Because you can’t conceive this. It’s a global capital market and every head of state and every governor and every mayor around the world is basically saying to global capital, “Come hither.” And you can only use two fundamental arguments. Either come hither because we are so cheap or come hither because we’re so productive. And that’s it.

Excellent. Thank you very much. Really appreciate your time.

Thanks so much.

Thanks. Good luck with it.

[End of Interview]