Economic Policy Institute

1660 L STREET, NW • SUITE 1200 • WASHINGTON, DC 20036 • 202/775-8810 • FAX 202/775-0819 www.epinet.org

STATE OF THE ECONOMY

Conference Call Transcript
August 12, 2003

Panelists

George Akerlof, Koshland Professor of Economics, University of California, Berkeley, 2001 Nobelist in Economics
Laura D'Andrea Tyson, Dean of the London Business School
Robert M. Solow, Professor Emeritus, Massachusetts Institute of Technology, 1987 Nobelist in Economics
Janet Yellen, Professor of Economics, University of California at Berkeley, former Chair of the Council of Economic Advisors and Governor of the Federal Reserve
Gene Sperling, Director, Center on Universal Education at the Council on Foreign Relations, former Director of the National Economic Council
Lee Price, Director of Research, Economic Policy Institute, former Chief Economist, Senate Budget Committee
Jared Bernstein, Senior Economist, Economic Policy Institute
Lawrence Mishel, President, Economic Policy Institute **(Moderator)**

INTRODUCTION

This is a transcript of a news conference call, sponsored by the Economic Policy Institute, which assessed the effectiveness of economic strategies being pursued by the Bush administration and analyzed the current state of the economy.

THE CONVERSATION

LAWRENCE MISHEL: I want to thank everybody for joining us, the panel as well as the reporters. The obvious context for this call is the fact that the economy isn't doing so well. We're experiencing the largest employment contraction since the Great Depression and even though we expect greater growth in the last half of the year, no one really expects unemployment to get down below six percent for many months to come. Thus, the President is considering what he should do next.

As I think you all well know, the people on this call all signed a statement last February recommending that the President's tax plan not be legislated. In so doing, we said that there was wide agreement that the purpose of the Bush plan is the permanent change in the tax structure and not the creation of jobs and growth in the near term.

So it won't be a surprise to us if this plan is not very successful in creating jobs in the coming months. You should also note that the Council of Economic Advisors projected that starting in July, this past month, if they passed the tax plan, the economy would be producing 340,000 jobs per month. That figure includes jobs that would be created because of the tax plan and jobs that would have been created by the economy anyway. Starting in September with the release of the August job numbers, the Economic Policy Institute will be tracking how much above or below that 340,000 target the economy hits.

Our first speaker today is Robert Solow, Retired Professor at MIT and a 1987 Nobel Prize winner in Economics.

SOLOW: Let me try to set the stage a little bit. We know that since the first quarter of 2001, total hours worked in the non-farm business economy is down about three percent. During that time during those two and some fraction years, productivity in the non-farm business economy was up about seven percent. And during that same time, the real compensation of wage and salary earners is up by less than one percent.

So just as Larry Mishel said, employment is stagnant to down. The labor force is up by roughly three million and unemployment is up by more than three million. If, as most people think, the normal rate of GDP rise in the U.S. now is three percent a year or more, we have fallen another 2 ½ to 3 percent behind potential production in the U.S. since the first quarter of 2001.

I don't think you can blame that kind of performance on the September 11th outrage or on the corporate scandal outrage or on uncertainty about the course in Iraq. Businesses will spend when they think there's a profit prospect. And consumers, of course, have been the heroes of this whole episode.

But I don't think that we have to go beyond ordinary macroeconomic business cycles thinking to understand what happened. And the last thing I want to say that for all the talk about stimulus, all we have had from the administration is increased military spending which is up 14 to 15 percent in the first quarter of 2001 in real terms. Tax cuts can't hurt - they're like chicken soup that way. But the particular tax cuts we've got - apart from what they've done to us in the long run - are designed to have minimal stimulus. To my mind, they're redistributive in intent and redistributive in effect. And they have contributed in large part to the dissipation of the huge budget surplus that we were looking forward to using intelligently. And all we have to show for that is the City of Baghdad. So, let me stop there and let someone else carry on.

MISHEL: Next is George Akerlof, Professor of Economics at the University of California Berkeley and the 2001 winner of the Nobel Prize in Economics.

GEORGE AKERLOF: My major theme here is: Is it necessary to reset the reference point in talking about the Bush economic agenda? Let me explain what that means. The debate has so far been much too polite regarding his economic policy. The popular discussion acts as if there might be some question ... some question ... as to whether the Bush policies are advisable.

But that sets a long reference point for how to think about these policies. The proper reference point is that the Bush fiscal policy is the worst policy in over 200 years. The debate about Bush and his economic policy should be: Is this the worst president in the last 200 years?

Well, my own view is unequivocal. No, there has not been a worse president. Now, I have thoughts on foreign policy and social and environmental policy. But let me explain the economic part of my consideration.

Any reasonable reckoning of the true fiscal deficit for the next ten years suggests that it is enormous. According to reliable sources, a ballpark estimate of a properly accounted ten-year fiscal deficit is almost $6 trillion. The calculation makes realistic assumptions about taxes and spending and also acts as if Social Security surpluses, the Medicare Trust fund and government retirement surplus have gone into a separate earmarked fund.

Now, $6 trillion is a very large number. It's so large, the deficits are of such magnitude that they threaten the fiscal integrity of the United States. My data are adapted from publications from the Center on Budget and Policy Priorities. So I'm only espousing the views of those who I take to have set forth the best and the most unbiased estimate.

For 200 years since George Washington and Alexander Hamilton put the United States on a sound fiscal basis, the fiscal integrity of the federal government has not been questioned. There were some problems with filing during the Civil War, but, of course, those were exceptional times.

There is, however, historical precedent for a government of the United States that was lacking in fiscal integrity. But that's prior to 1789. Under the Articles of Confederation, the government was too weak to collect the taxes it needed to pay for its purchases.

The net result, as we all know, was massive instability of the currency. The leaders of the times wisely met in Philadelphia and enacted the United States Constitution. Since that time, no president has ever contemplated policy so irresponsible as to recreate fiscal crisis on the scale of the Articles of Confederation.

The most pressing problem with the articles was red ink as far as the eye could see. And therefore, the government could do nothing. It could not borrow. It could not tax. It could not spend. So that is what I see happening now. Economic policy is by far the worst in our past 200-year history.

In a very short period of time, in ten years, we are going to begin to pay the very serious price for this current irresponsibility.

MISHEL: Thank you, George. Next is Laura Tyson who's currently the Dean of the London Business School and formerly head of the National Economic Council and the Council of Economic Advisors.

LAURA D'ANDREA TYSON: Well, thank you. I have the dubious distinction of going after two Nobel laureates, one of whom was my professor years ago. So I will be very brief. I agree with what they both said. I will elaborate a bit or just give a slightly different set of numbers on what George said, which is really to focus on the overall fiscal stance this government has adopted.

Rather than go back 200 years, I just tried to think about the last decade. And what I would say is we're back to a world of structural budget deficits. I think that attacking the deficit was one of the great and very hard-fought accomplishments of the 1990s. It involved very difficult budgetary battles between the Republicans and the Democrats, ultimately coming to bipartisan support for a fiscal budget at the federal level which would balance structurally - actually, had *surpluses* structurally - which was the right policy because of the forward needs and demands of the Social Security system.

That has been totally undone. We not only have the short run issue of the deficit and the short run issue of the state of the economy and the inappropriate use of policy in this case to stimulate the economy, the ineffective use of stimulus here, but we also have the structural budget deficits, come expanding economy or contracting economy.

The second thing is we're back to gimmicks. I think one of the hard won battles of the 1990s was to go for reasonable budgetary projections based on reasonable economic forecasts and to eliminate smoke and mirrors.

Not only do we have unreasonable economic forecasts now, but we have new gimmicks like sunset clauses - that no one believes in - that undermine the credibility of the federal government in the eyes of U.S. citizens and in the eyes of foreign capital markets, which over time is more dangerous.

We're back to supply side growth logic. Even though the Joint Committee on Taxation has finally gotten around to some dynamic scoring, the dynamic scoring has not worked to the benefit of the supply-siders in this case. Deficits do matter. And over time, deficits will negate any of the incentive effects of the tax cuts chosen by this administration on the growth side.

This is not a growth package. It's not a stimulus package. It is, as Professor Solow said, a redistributive package in both intent and effect. Neither growth nor short-term economic stimulus is really the cause of these policies or the consequence of these policies.

We're back to David-Stockman-like logic, which goes: if you take enough revenue away from the government, you're going to have to force cuts in government spending. One out of every three dollars the federal government now spends outside of Social Security is financed by borrowing - at the same time that we are saying we're going to introduce a new Medicare prescription drug program.

Federal income tax revenues as a share of GDP are now down to levels not seen since the mid-1940s when we didn't have Medicare, we didn't have Medicaid. We essentially do not have a federal government going forward that is equipped with the amount of resources required to meet the current commitment, much less the commitments we have promised that are in law right now and the new laws we are making to the future generation of retirees.

We're moving to a wage tax without any real discussion of whether that is the appropriate way to move in the United States. At a time when, given the productivity numbers that Professor Solow indicated and the growth in the labor force we have, we might be considering things like tax credits as opposed to moving to a wage tax. Nonetheless, that is where we're going.

So those are only a few of my concerns about the current economic policy of the Bush administration. I'll stop there.

MISHEL: Gene Sperling, former head of the National Economic Council in the Clinton administration.

GENE SPERLING: It is an honor to be on with the previous speakers. Let me follow on a few of the things they are saying. First of all, I do think the administration gets far too much credit for walking and chewing gum at the same time on stimulus.
We've had a weak economy for 30 consecutive months. There seems to be a presumption that if any stimulus happens to pass anytime during that thirty months we should marvel at the timing of this. But the real test, as has been said, is, number one, does the stimulus have a strong bang-for-your-buck impact on stimulating demands and job growth? And number two, is it being done in a way that instills confidence and is consistent with long-term growth and productivity? I think it clearly fails on all these measures.

And it’s worth a little bit of even short-term history. Just the last couple of years show how little the administration has ever truly been focused on stimulating the economy and how things might have been different with a different philosophy.

In 2001, the overwhelming focus was this long-term redistributive tax cuts. Let’s remember that the notion of even sending out any checks in 2001, having even one penny of stimulus in 2001, was never in the administration’s initial proposal. It was never even agreed to by the administration until May, and then it was a response to Democrats who were calling for a rebate and whose votes were needed to pass the bill.

Then following 9/11, you had an enormous ability to pull the country together for a quick stimulus package that could have focused on states, unemployment insurance, and very targeted tax cuts to individuals and businesses. The administration launched on an effort to retroactively repeal the corporate alternative minimum tax, to have deferral of Subpart F treatment of income foreign subsidiaries, to accelerate the highest parts of the tax cut.

This led, of course, to stalemates, to no stimulus happening by the Christmas shopping season and ultimately to a very weak 2002 package. I’d refer you to the January 2002 Congressional Budget Office analysis, where they went through the administration’s different proposals and found their planned accelerations would have a relatively low impact, and found the retroactive AMT to have no incentives for its new investments, relatively low bang for the buck.

All of these are in the Congressional Budget Office January 2002 analysis, which then brings you up to 2003. Having failed to really make stimulating job growth and demand the heart of their plans, they then came forward with the plan that every single independent analyst looked at the hearts of it, which were the dividends and the capital gain tax, as having relatively low stimulative impact. Goldman Sachs found eight cents on the dollar of dividend impact for 2003 and 2004, and economy.com found virtually the same.

So the fact that some stimulus has made it into the economy is not a significant achievement in light of how weak their three-year effort has been and, as has been suggested by the previous speakers, how significant the harm has been in terms of our long-term fiscal situation. You’ve heard George Akerlof say how serious these choices are. I agree. Hands down, this is the most fiscally irresponsible administration in history.

This tactic of not even confronting the tradeoff, but having Cinderella tax cuts that are supposed to magically expire at midnight - when we all know that the whole purpose is that they will be extended permanently and that any politician who does not vote for permanently extending them will actually be accused of raising taxes.

Dennis Hastert, Secretary Snow, Bill Thomas, virtually every person as they passed the Cinderella tax cut said simultaneously that they planned on extending them at the first chance they get. So perhaps, they're really the Emperor-wears-no-clothes tax cut. We all know what's going on. And as we just pointed out, we realize we can see how deep the damage is.

Two numbers show just how harmful this is economically. In 2004, there was supposed to be a $369 billion surplus. Instead, we're projecting a $475 billion deficit. That is an $844 billion swing in one year.

Imagine if the previous administration had left projections of, let's say, a $300 billion deficit. Then we would have deficits this year of over a trillion dollars, over 10 percent of GDP. By leaving us with long-term projections of high deficits this administration is taking away our country's ability at a future time to deal with crisis, with stimulus that would not be damaging and lead to just unheard of deficits of over 10 percent levels. So it will take away our fiscal flexibility. And in doing so, also some of the monetary flexibility that existed in the '90s because fiscal policy was under control.

The last number, which I think is really most important, is to add up all of the Bush tax cuts that have been passed and look at their cost ten years from now. In 2013, the cost of the Bush tax cuts with the lost interest combined is $493 billion. $493 billion. That is nearly three percent of GDP. That is a permanent loss, not even including if we had to fix the alternative minimum tax entirely.

Just to give an example at three percent GDP, it takes about 1.9 percent of GPD permanently to fix Social Security and Medicare on a permanent basis. So this is more than one percent higher than what would be needed to restore Social Security or Medicare solvency - or three times larger than what it would cost on an ongoing basis to make Social Security solvent over the next 75 years. So there's been an enormous tradeoff in our fiscal future with virtually no discussion, done on the pretext of stimulating job growth and economic demands through stimulus that wasn't even well targeted or had a high bang for the buck.

MISHEL: Janet Yellen, Professor of Economics at University of California at Berkeley, former Chair of the Council of Economic Advisors and a Governor of the Federal Reserve.

YELLEN: I want to begin by emphasizing my agreement with the points my colleagues have made concerning the Bush administration's economic policy. The administration's fiscal policies, particularly the tax cuts that have been enacted, are, in my view, economically reckless. I believe that escalating federal deficits and debt will have very negative long-term economic consequences. It is distressing to hear President Bush touting the positive "supply side" impacts of these tax cuts when objective analysis by the CBO and JCT, using the dynamic scoring techniques favored by the administration, undermines the validity of this claim. Like George, I am also concerned about the increasingly duplicitous nature of budget projections. These projections are filled with gimmicks and accounting conventions that obscure the scope of the problem to all but the most sophisticated observers. We are on an irresponsible budget binge.

Fiscal policy should instead be addressing America's real problem--which is the dearth of jobs resulting from inadequate demand for the economy's output. We need a fiscal package to boost spending now while minimizing long-term budget damage. President Bush claims that the tax package passed this spring will help to create jobs. I agree. But the question is how many and at what cost. My answer is: not many and at way too high a cost. Tax cuts maximize their bang per buck when they are temporary and directed at cash-strapped low and middle income families, who will spend heavily out of extra income, not the nation's wealthiest households who will disproportionately save them. But, it is the wealthiest households—the top 1%--that receive the bulk (29%) of the Bush tax cuts whereas only 7% go to the bottom 60%.

In my view, a much better option, on both stimulus and fairness grounds, would have been to provide much more temporary aid to beleaguered states. With $80 billion in forecast budget shortfalls for 2004, states face the bleakest budget conditions during the postwar period. Most states are laying off workers, cutting spending, and raising taxes. These actions will retard a recovery and also curtail high priority government services particularly education, healthcare and public safety.

In ordinary times, we do not need to rely on fiscal policy to stimulate the economy. In ordinary times, the Federal Reserve can manage the business cycle on its own, leaving fiscal policy to focus on long-term goals. But these are not ordinary times. The current recession is not typical. The United States, like Japan, is suffering the aftermath of a collapsed stock market bubble and an overhang of corporate investment. There are certainly many forecasters, including many of the FOMC members who are meeting as we speak, who are optimistic that the worst is over and a rebound is around the corner. They can point to tentative signs of improvement. But there is no firm evidence yet of a self-sustaining expansion. After its bubble burst, Japan discovered that such excesses can be long-lasting. Japanese forecasters were similarly but wrongly optimistic.

The current situation is also unusual and dangerous because, for the first time in memory, inflation (at just above 1%) is not too high but rather too low. It is likely to continue falling as long as slack in the economy remains. Deflation, as in Japan, is remote but not unthinkable. With rapid productivity growth, anemic growth in demand will neither create jobs nor arrest disinflation. Very strong growth in demand—above 3.5 or 4%-- is required.

Finally, the need for a responsible fiscal policy is unusually great now because with the Federal funds rate at 1%, monetary policy, as in Japan, is fast approaching its limits. As those limits are reached, additional fiscal measures could be urgently needed to kick start growth. Japan found its scope for imparting fiscal stimulus, however, severely constrained by its huge, looming deficits, high debt, and aging population. With large, looming long-term deficits on the horizon in the United States, fiscal policy may soon become similarly constrained.

MISHEL: Thank you. The last speaker is Lee Price, currently Director of Research at the Economic Policy Institute and most recently Chief Economist for the Minority on the Senate Budget Committee.

LEE PRICE: The downturn in jobs that began in early 2001 marks the worst 2½-year record with job creation since the Great Depression. It's been 29 months since the last peak in jobs and we're still on the down slope. In this year alone, we've lost a half a million jobs, with six consecutive months of declining jobs. All told, we're down by 2.7 million jobs overall and by 3.2 million jobs in the private sector.

Before this, the most drawn out job slump had occurred in the so-called jobless recovery of the early 1990s. But even then we hit bottom and we were back on track adding jobs after 20 months. Within 32 months, we had completely recovered all the lost jobs and were hitting new records of numbers of jobs.

So, we're doing much worse than the so-called jobless recovery of the early '90s. This time, 29 months after jobs began dropping, there's no sign of net job creation, much less any visible prospect of getting back to the old peak. It's important to keep in mind that we've got millions more people who have reached working age than have retired since early 2001. That means that if we're going to get back to where we should be, it's not enough just to restore the jobs that we've lost. We need to add millions more for the new labor force entrants and to bring the unemployment rate down.

This dismal job picture has brought a dramatic slowdown in wage gain. Back between 1995 and 2000, the average worker in the middle of the pay scale was seeing wage gains running two percent above inflation. But since the end of 2001 when the tepid recovery in output began, the average worker, the one in the middle of the pay scale, has been treading water with pay that has been keeping even with inflation, but no better.

Today's bleak labor market was not inevitable. Over the last 2½ years, the President and Congress have squandered at least $5 trillion resources for the ten years going through 2011. If the administration had instead focused on pulling us out of this immediate labor slump, the jobs situation would be much better – and at a fraction of the long-term fiscal cost.

QUESTIONS AND ANSWERS

HOLLY ROSENKRANTZ (Bloomberg News): The Wall Street Journal today reported on how the world economy is recovering. And I'm wondering if that would translate into a boost for U.S. growth next year. And if it does, would that benefit President Bush in his re-election?

TYSON: Well, what I would say is it's certainly good ... I haven't seen the article. It would be good news for the global economy if there are some signs of recovery. Certainly an improvement in foreign demand would help the U.S. And certainly, a continued long-term weakening of the dollar would help the U.S.

I think one of the important messages that comes out of this conversation, and I really want to emphasize this, is there may be some improvement in short-term economic growth next year. It may possibly come in part from the rest of the world. That misses the main arguments made here. Number one, that we have had a lot of sustained job loss that we could have avoided if we had had much better targeted stimulus policies. Number two, the policies we have put us in an absolutely dreadful fix from the point of view of the longer term.

So it's good news if the global economy shows some signs of recovery. There will be some positive benefits for the U.S. It misses the point, though, of why the policies pursued by the administration have been so reckless.

WILL LESTER (Associated Press): Let me ask Gene why, if these things are all true, why is it that the public doesn't seem to be totally buying into your idea that we're on a reckless path.

SPERLING: I'm not really sure that I would accept your premise. First of all, I don't think there's any question that the focus on foreign policy and terrorism has certainly crowded out a lot of economic news and discussion. But as far as I see, the public does not have high job approval marks for the President, even for a wartime president. And when asked whether they're worried about tax cuts or deficits, they actually do show some more concern about deficits.

So, first, I don't know if I totally accept the premise. But I guess I would say two additional points. One, I do think that there is at times a lag on public recognition of shifts in fiscal policy. And I think the administration has spread the message that the fiscal deterioration came only from war and recession.

As we move farther away, coming on two years, from 9/11 and coming on two years from the official end of the recession and people still see that we are now seeing three, four, five hundred billion dollar deficits where there were once projected four, five hundred billion dollar surpluses, the recognition will grow larger that there has been a fundamental deterioration in our fiscal situation.

Second, I think that hopefully a presidential election will allow some of these issues to come to the forefront. And finally, I think this administration has made a tactical effort to hide and distort what the long-term tradeoffs are. Remember, all deficits are described as simply the impact of war and recession. All tax cuts are framed in ways to reduce the sticker shock, to have artificial sunsets that nobody believes are realistic.

So I believe the administration may have been successful for a short time in hoodwinking the public about the dramatic long-term tradeoffs that are being made in terms of saving for Social Security, Medicare and long-term fiscal situation. But over time, you know, they can run, but they will not be able to hide the truth of the dramatic fiscal deterioration that has happened, not only under their watch, but explicitly because of their own politics.

ELIZABETH BUMILLER (New York Times): Why are you doing this? I mean, tomorrow the economic team is coming to Crawford. Is this an effort to get out in front of what you consider a continuing sort of whitewash of the economic situation in the country by the White House?

MISHEL: It's always useful to have important analysts comment on the economy, especially as it's about to be profiled tomorrow. So, yes. This is to provide a balanced perspective on the course of the economy and an analysis of the current administration's policies.

BUMILLER: And how much do you think they're distorting what the reality is out there?

SOLOW: I think the burden of what everyone has said so far is that all the tight-lipped optimism is distorting what is happening now and, even more so, what will happen in the future. I would add to what Gene Sperling said a moment ago that the fiscal policies of this administration are a systematic matter of sacrificing the future. You know as well as I do that the last calendar date that the administration cares about is November 2004. And the damage that's being done, both to the labor market and to the budgetary position of the government, is not going to suddenly collapse between now and 2004. It's probably five to ten years down the road that the serious damage occurs. And that's no doubt a standard political device, but it certainly is what we think is happening.

MISHEL: Let me just add that when it comes to the economic performance so far, the administration blames everybody but itself. The stock market bubble, the war in Iraq, 9/11. And doesn't take responsibility for the fact that they've legislated $5 trillion of tax cuts with no apparent important positive impact on the economy. When it comes to the future, they're talking about how the economy's going to turn around, but not discussing the fact that even with the faster growth, we're still going to see very little job growth and very high unemployment into the foreseeable future.

JUDY KEEN (USA Today): You've all described a fairly dire situation. We've been led to believe that no new initiatives or proposals will be forthcoming from the administration after tomorrow's meeting. What should be done?

SPERLING: I believe what we've needed for a long time is a grand compromise in which there's an agreement to do more short-term, truly stimulative efforts to jump-start job growth with a bipartisan agreement to restore long-term fiscal discipline. I think that would have a number of benefits. It would provide more immediate confidence and more immediate stimulus, particularly to the states where people are waking up every morning and reading about teacher layoffs, tax increases, spending cuts.

Second, it would restore the long-term confidence in the U.S. economy's investment climate. We've just seen in the last month the IMF scold the United States for running too high deficits that are going to hurt savings, hurt U.S. productivity growth. We've seen the same from the BIS, the Bank International Settlements. This is a throwback to ten years ago when the rest of the world was losing confidence in the U.S. because of our fiscal situation.

So I believe that if you have a situation where you pull back on these tax cuts that are largely aimed to the most well-off and use some of that to restore fiscal discipline as Democrats as part of the agreement to pull back on very expensive proposals of their own, perhaps in the health area.

But at the same time, use some extra resources to help with some of the state contraction that Janet mentioned. This is the type of serious bipartisan leadership that we could use now to help get the economy going right now and restore long-term fiscal discipline.

KEEN: You mean that, for example, prescription drugs for Medicare recipients should be delayed?

SPERLING: No, I think that ... and this is just me speaking. I think that what you saw in the '90s was a bit of a bipartisan commitment to long-term fiscal discipline. What you're seeing now is that is replaced by a bidding war. Once you have the administration spending two, three trillion dollars a year on tax cuts that are largely benefiting the most well-off, of course other people are going to call for those resources to be spent on areas that they think are more progressive. That's why you need to aim for the type of bi-partisan commitment. That can only happen when you have leadership from the White House. Ronald Reagan passed one large tax cut in 1981, one irresponsible tax cut, then in 1982 raised taxes, 1983 he had another actual tax increase in terms of Social Security Reform, and in '86 tax neutral reform. Here you have an administration that, unlike with Ronald Reagan, comes back each and every year almost every six months with another deficit explosion device. There will never be a return to fiscal discipline or a bipartisan commitment until they lead by being willing to pull back and help us restore fiscal discipline. When they do that, they will then have the moral high ground for the first time to ask for more of the same commitment on Democratic priorities. But with that kind of confidence that will restore our long-term fiscal discipline, it would certainly provide us with a bit more room to help states stop having to raise taxes or cut education or do things that are both contractionary and harmful to long-term productivity growth as well. It think it would be very easy to repeal part of this enormous tax cut that's gone to the most fortunate among us, and use those funds for state relief that would actually lower taxes and lower education cuts on tens of millions of …

JARED BERNSTEIN: I just want to suggest one other piece of the puzzle. It is widely agreed that the unemployment rate is going to be at or near six percent for the rest of this year and throughout 2004 as well. Therefore, another extension of the unemployment insurance benefit program would also be a great idea, both in terms of meeting the needs of the unemployed and stimulating the economy. Talk about bang for the buck – that's a great way to meet both those needs.

SOLOW: I'd have to agree. I think that's exactly right and I'm glad it was brought up. In thinking about this, you have to distinguish between the short run and the long run. If we're going to have a decent prescription drug benefit, then that's a long-run proposition. That's not something that we're doing for today. And it should be financed in a long-run way. And my way of doing it – and I think this is what Gene suggested – would be to take back some of the least useful or most useless tax cuts that we've already given down the road.

If we're talking about getting the economy back in shape now, that's a different matter. There are three characteristics you want a stimulus package to have. One – that it stimulates. Two – that it be temporary. And three – that it not pursue a partisan political agenda. Everything that the Bush administration has done has failed all three of those tests. A good thing to do in the short run is, of course, extension of the unemployment insurance and would certainly be some temporary grants-in-aid to the states until their revenues come back. Those would give you stimulus right away. They would be temporary and they would not be partisan politically. But that doesn't seem to be the direction that we're going.

EDUARDO PORTER (Wall Street Journal): Who's going to fund these deficits into the future? So far, foreign money has been quite robust. And I wonder if you expect that to carry on, or how is that going to play out the funding of deficits and how that will affect the dollar?

SPERLING: That was exactly my point. One doesn't know how these deficits will possibly be extended into the future. Eventually what you get is going to be some kind of crisis. There are two possible crises. Each one is very difficult to contemplate. One is that we might need to cut back seriously on our promises to older people in terms of Social Security and Medicare. And the second possibility, which gets worse, is that we would have some kind of crisis when the government is unable to borrow. At some point we're going to have to make some very tough decisions because we're being irresponsible now.

AKERLOF: I think that the question was bearing on the current account deficit. There too the uncertainty is great. So far the rest of the world has made it advantageous for the American economy by financing our current account deficit because their own economies are in pretty bad shape. We were talking earlier about the desirability of having recovery in Europe, even a small one. That might make foreigners less willing to place their wealth in dollar assets, if they can do better at home. We have created that other margin of vulnerability that the rest of the world could decide, and could even decide suddenly, that it doesn't like dollar assets anymore. That it thinks that our own public policy or our own currency is not good enough for them, and then we would have yet another difficulty.

TYSON: Could I say one other thing on this? A few months ago when the Bush administration was trying to float the line that deficits don't matter – a line that they quickly backed away from because there was resounding criticism correctly placed – there was a very good analysis done by Peter Orzag and Bill Gale at Brookings. Basically, they laid it out: when you have a deficit it might show up in a larger current account, or it might show up in higher interest rates and crowding out private investment at home.

Either way you can crowd out the use of the resources by private sector at home in investment, in future technology, in future capacity and all the rest. You can crowd out some investment from around the world by attracting money, and from the rest of the world to finance the U.S. government deficit. But, either way, there is a reduction in the assets owned by the U.S. citizens relative to what otherwise would have been the case. You just cannot get around that. Whether there's a foreign exchange crisis at some point, a dollar crisis, or a current account crisis. I do worry, like George Akerlof does, about what the rest of the world is going to think.

As the evidence continues to mount and once you really understand the sunsets and once you really understand the commitment to Social Security and Medicaid you see the size of the federal government's borrowing claims going out a decade or so. The rest of the world may indeed take a step back and say, "Well, we'll only finance this on slightly different terms." And the slightly different terms might be much less attractive to the United States and therefore the investment opportunities open to the private sector in the United States might be much less attractive. Those are the kinds of things I think one needs to think about.

I want to emphasize something that Gene said about all the things we have given up that we just had just a few years ago. We've given up discretion, because – as Gene correctly pointed out – you couldn't have done some of the things the Bush administration has done if they had not acquired the very hard-won surpluses which had come from a very difficult bipartisan effort through the '90s.

The federal government of the United States started out with a great deal of credibility in the international economic community. We were the ones who had gotten our house in order. We were the ones that had the economy that both from the government policy point of view and the private sector point of view was credible, effective and the one to emulate. Now frankly, with the corporate scandals and now with a federal government whose policy is increasingly viewed as reckless and unsustainable by the rest of the world, we've lost credibility on both counts. That will cost us, in terms of the ability to depend upon the rest of the world for financing. I can't tell you exactly the terms, but it's going to cost.

LEE PRICE: Chairman Greenspan has noted several times that the current account deficit of five percent of GDP, adding to our international indebtedness that is now 25 percent of GDP and rising to 30, 35 and 40 percent in coming years, has to be reduced.

What we've had for the last couple of years is this artificial environment where businesses haven't been investing, but foreigners have been sending us all their savings. So interest rates have been temporarily low, even as we've had these huge deficits. That's Never-never Land. It can't be sustained.

The rest of the world is not going to keep lending us five percent of our GDP forever. We're not going to have business investments at such low levels. And when businesses try to invest more, and foreigners decide they can't lend us as much, then there's going to be a crisis. It's that kind of crisis that happened in the late '80s when everybody seemed to understand that deficits can crowd out interest-sensitive industries -- business investment, housing and autos. That's going to come at some point. We've been living in a dream world for the last two-and-a-half years with people thinking that deficits don't matter.

WARREN VIETH: Does anyone include the cost of rebuilding Iraq in their calculations of the government fiscal situation? Or is the assumption that reconstruction will be largely self-financed?

TYSON: The official projections, of course, don't include them. I think some of the larger ones do. The six trillion…

SPERLING: I think that the larger numbers that Goldman Sachs and others have put out – four or five trillion – have tried to add what are the likely costs. In other words, they assume that discretionary spending just grows at a traditional rate, they assume some fix of the alternative minimum tax. In the $475 billion – that is the official OMB estimate for 2004 – it is not included.

VIETH: They've been running about five billion a month. And, depending on how long you want to estimate it, that's what you don't know.

SPERLING: This is the general argument: Where you have uncertainty it argues for being more fiscally conservative than the rest of your budget. And that is one of the principles that has been lost. There seems to be this notion that because the future is uncertain, that's a reason to be reckless. Usually, the general notion was that because the future is uncertain, has a variety of potential risks - for example, I believe we as a country have no idea how much we'll spend on homeland security – so these things argue for caution and fiscal conservatism. That principle has certainly not been adopted recently.

MARTY CRUTSINGER (Associated Press): Private economists are forecasting that GDP growth is going to pick up 3½ percent or more in the second half of this year, over 4 percent next year. The administration is sure to assert that rebound occurs proves that their policies are working. Does that undercut some of the arguments that you're making?

SPERLING: Marty, the administration always wants to pretend that their economic policy starts on the first day of their most recent policy. So one is going to have to judge all for their tax cuts and all of their stimulus efforts. Eventually the economy will improve. But it is very likely that you will end this four-year period with probably the worst job record and actually two or three million net job loss.

So, I think that it does not negate that there could have been a much stronger job growth had there been more of a focus on bipartisan short-term fiscal stimulus [instead of] partisan long-term tax cuts. And second, these quarter-by-quarter variations don't really go to the larger issue of what it's done for our long-term fiscal future and fiscal growth prospects.

MISHEL: The administration forecast in February that if we passed the tax cut, they were going to be creating 340,000 jobs a month starting in this past July. I think they should be judged on whether they can accomplish that. The fact that there's going to be positive job growth or even economic growth of 3 or 3½ percent is not success. That's the amount of growth we need just to keep unemployment from rising. We need far faster growth than that. We could expand far faster than that and should be, especially given the amount of resources that they put into all these tax cuts. Any one of us on the phone could have spent that money and had the economy humming by now.

SOLOW: Keep in mind that it's fairly normal after U.S. recessions for the rebound to give you a year or so of growth on the order of magnitude of six percent country-wide. What we had was a fairly short recession followed by a fairly long period of near stagnation over the last year and a half. A pickup to even to four percent in 2004 amounts after three years or so to the economy growing at about one percent a year faster than necessary to stay in place.

Moreover, there's no way to credit that pick-up over the next year to policies that have been undertaken ever since the beginning of 2001. No one ever forecast that an upturn in the business cycle would never come.

BOB HERBERT (New York Times):What effects can we expect that the continued fiscal problems in the states will have on the national economy?

YELLEN: [California is] involved in massive cuts in spending and tax increases and this has a major negative effect on the economy. And it is a serious drag on this economy going forward. Now, any sportscaster taking that into account will see a likely recovery during the coming year. But I think unquestionably with $80 billion in the state's aggregate of deficit spending for fiscal 2004, spending cuts there – and we're seeing more massive cuts daily - will have a major drag on the U.S. economy.

BILL NEIKIRK (Chicago Tribune): [I've heard critics of the Clinton administration say for years we inherited a recession and the previous administration is to blame for this trouble. Is this true?]

TYSON: Market economies have business cycles. We had a long and particularly strong economic expansion in the 1980s. It was the longest and strongest in the U.S. peacetime economic history. At the end of that, for a variety of reasons, including what was happening in the rest of the world, equity values got out of line with fundamentals as sometimes happens.

And indeed, it was the collapse of the equity market and the realization attended upon that of over-investment in technology, which led to the recession. There are plenty of factors to explain that.

What the Bush administration cannot get around is that there were many things that could be done to ease the pain of the recession or certainly to stimulate a stagnant, relatively stagnant, recovery. And every time the administration had a choice to make, it made a choice which didn't do that. It never has chosen policies that were well designed, well targeted and cost-effective to deal with the problem that existed. And there was a role for fiscal policy here. It was a role that was not even controversial among experts.
Go and look at Goldman Sachs -- it's not noted to be one party or another -- and what you'll see again and again is observations that the packages chosen were not stimulus packages in the true sense of the word. Sure, any tax cut in a stagnant economy is going to have some stimulus effect. There have been a series of very significant lost opportunities which creates major problems for the future. So I certainly feel absolutely comfortable saying this administration is to blame for the economic policy choices that have been made and have not addressed the economic problems of the times.

I think the Clinton administration actually did address the economic problems of that time. And it was a very difficult thing to do. What needs to be done is not going to be done by this administration. They have made that entirely clear.

So it will be done by another administration. And it is a very tough job. It is not a fun job. It is not an easy job. It is going to be a very, very difficult job.

MISHEL: This is Larry Mishel. On the blaming the recession on the prior stock market bubble: Where were those economists in the administration saying that we had a stock market bubble back in 1999 and 2000? They weren't there. So it doesn't seem to me that they have much of a claim to be able to blame it on the stock market bubble at this point. It's also that act of omission as well as commission.

DAVID NICKLAUS (St. Louis Post-Dispatch): We talked about job loss due to recession. It seems that at least some part of the loss has been a sector and a permanent move of manufacturing jobs to the Far East. Does anyone have any policy descriptions for addressing that?

SOLOW: This is Bob Solow. I don't think that we ought to worry in our policy for preserving manufacturing or preserving something else. That's a different matter. What we want are productive, well-paying jobs. And manufacturing is one source of such jobs. We are, like all rich countries, at a disadvantage in the labor-intensive, low-skilled labor market. That's not going to be our future or Europe's future.

TYSON: Another really unfortunate consequence of where we are is there is going to be a growing voice in the United States about jobs loss to Asia or job loss to China or job loss to India. That isn't what has happened here. There are some jobs one can point to as part of a long-term, secular trend of movement of jobs to other parts of the world. That's not going to go away. If we get back into a policy debate, which is what we should do to protect ourselves from that, we have lost so much ground trying to make the case - which I think the Clinton administration made in the 1990s - about the benefits to the United States of global interdependence.

So the failure to do good domestic policy at home is creating incentive for people to look to villains abroad. And that's just another tragedy to come out of this botching of American economic policy.

MISHEL: I think more people don't agree, however, that we have an inflated dollar. This has had a sector-specific impact on manufacturing and better policies could have yielded not just a less inflated dollar -- which has hurt manufacturing – but could have solved problems caused by certain countries like China, which take their rates to the dollar and are able to take advantage of that in a way that might not be helpful. So that there are international economic issues that one can discuss. It's not just about this is a long-term shrinking manufacturing. We've lost millions of jobs and not all of them are due to faster productivity.

JERRY IDASZAK (Kiplinger's): A question for either Laura who mentioned David Stockman or Gene who mentioned Ronald Reagan. Is the strategy of the Bush administration's fiscal policy to starve spending? Or do you think it's simply that they think that more voters will applaud tax cuts and various claims, rather than increase spending?

TYSON: Well, I'm not in their minds. Whenever I hear a Bush administration official say that they believe we can handle the Social Security problem, or the Medicare problem by reforming the system, I don't find that a credible statement. And I don't think that they can believe it either.

So I think that the generational issues in these tax cuts are dramatic. I've looked very carefully at Medicare over the years. And I know that any credible expert on health care reform does not believe that there is enough money to be saved in Medicare reform to pay for a long-term prescription drug benefit. And does not believe there is enough resources in long-term Medicare reform to handle the cost issues of Medicare without prescription drugs.

So, that's not a credible statement to me. It suggests to me that people are cutting taxes at the same time they are saying that they have in mind the notion of scaling back Medicare in a serious way. And I would say that since we also know from bipartisan sources that even if you accept the notion of "saving Social Security" by transitioning some of the resources to private sector accounts, the evidence, the numbers are overwhelming that you'd need more ... more ... not less resources to do that.

So again, people in the administration who will say, in the same paragraph, that they can defend these tax cuts and they believe we'll have to reform Social Security to make it solvent, basically those two things can't be said in the same paragraph to me and be credible. And since they're acting on tax cuts and not acting on Social Security, I frankly conclude that at the end of the day, some of these officials - certainly among some of the Republican Party - plan to take the resources away and then force reforms which are in the nature of cutbacks.

SPERLING: There's a business cycle and there's also a kind of fiscal hypocrisy cycle. And the way it usually goes is there will be these very, very expansive tax cuts. And then once large deficits are created, there will then be a kind of reborn fiscal discipline among many Republicans who will then seek to do that through balanced budget constitutional amendments and spending cuts.

When I said it was worse than Ronald Reagan, I mean that besides the fact of continually repeating additional fiscal deterioration in the face of a deteriorating outlook, there is also the fact that we are 20 years closer to the baby boom retirement.

There was an absolutely bipartisan, uncontroversial statement in the past that said the fundamental entitlement challenge was to save more now, so that we would not be passing on that burden. Secretary Pete Peterson and Warren Rudman are two Republicans that still carry that message.

But when you see a message that actually dramatically increased consumption and reduced savings now, it is hard to see any other effect. It will put very significant pressure on not only Social Security and Medicare, but unfortunately when you start facing a choice of, on the one hand you either have to raise taxes, or on the other hand, have to cut Social Security and Medicare. The one group that you're sure to lose is the politically powerless and the poor who will not do very well in that very painful fiscal competition.

JIM TOEDTMAN (Newsday): This is directed at Janet Yellen. Is there a chance that California as big as it is and with the $38 billion deficit that it faces it could trigger a snowballing effect? It could have a significant impact even larger than your forecasting?

YELLEN: In terms of economic impact for the moment, I think California has decided to use gimmicks and to push the problem into the future rather than to accept tax increases or spending cuts. So it's a sense of very near term impacts on spending I would expect that over the next six months to a year. But the level of fiscal responsibility in California, the level of unwillingness to accept responsible ways of dealing with the problems and the bond market. You see the bond market's reaction to that with California bonds now being just shy of junk status. I think this is the kind of thing that would could see in a larger scale and at federal level as the realization dawns that you're pursuing irresponsible fiscal policies with huge long-term that realization will come to bond markets eventually and I think we will see similar consequences.

TOEDTMAN: But nothing short-term?

YELLEN: Well, I don't expect to see massive spending cuts, but certainly we are seeing borrowing costs rise and that could be more widespread.

JAMES GIBBONS (Houston Chronicle): You spoke a little bit about the administration's short-term political motives, but why are so many wealthy and powerful interests and commercial interests willing to go along with it if the policies are that damaging? Wouldn't they make more money from a sound economy than from just distorted ones?

TYSON: I have a couple of observations on that. One is that there is some short-termism here. For example, the support of the dividend tax cut. This was not a commercial or business priority. It wasn't high on anybody's list as an action item. It came largely out of the Bush administration and a few of its quarters. There were lots of business interests who then would buy onto it. It's something that might have the effect of elevating some stock prices, reviving the financial services industry. It has some sectoral attractiveness to it. Part of it is sort of opportunism, I suspect. It's part of what Gene was referring to as the bidding war. You get on the bandwagon. Fiscal responsibility is out the window. So therefore, you may as well get your policy in, because that seems to be the game of the day.

During the Clinton Administration, we fought tooth, and nail and it was very costly to the President, for the tax increase on the top 1 ½ percent. We believed as part of a fair and efficient and credible deficit reduction program, it was the right thing to do. The people who were going to pay the higher rates were both fiscally responsible in a lot of what they would say about the government in general and dead set against that particular policy which affected them.

So I do think that if you give up fiscal responsibility, everybody's in it for themselves.

SOLOW: Something similar to what Laura just described happened in the Reagan administration not that long ago. There was a part of the business community and the Republican Party that thought the fiscal policy was irresponsible and wanted to stick to what normal conservative people believe, but in the Washington electoral competition, they lost.

MISHEL: This administration is known for being very harsh on its enemies and enforcing great discipline on its allies. I think you not only understand the support for their policies as playing politics. How else can you explain the Business Roundtable coming out with a stimulus plan saying that the problem is we have insufficient demand. And then a month later supporting the president's package, which has nothing to do with stimulating demand, but stimulating cost. So, I don't think it's necessarily about logic or economics, but about politics.

GREG ROBB (CBS Marketwatch): I have a question going back to Professor Yellen. I missed what you were saying at the beginning because there was so much noise on the call about the U.S. economy experiencing something that might be typical with what's going on in Japan or Japan's experience over the last decade. Could you talk more about that?

YELLEN: Yeah, I meant to argue that these are unusual times in which fiscal policy has a special role to play and we might face downside risk to the now because we've had a collapse of the bubble. We hope growth will resume. Perhaps at will. But on the other hand, as we've learned from Japan, if you seem to be too optimistic, growth may not resume. And it's importantly the Federal Reserve that we normally look to and count on to be the first response line in terms of taking actions to stimulate the economy, we face a liquidity trap. And the Fed is just about out of room to do anything to further stimulate the economy.

I think probably the committee is sitting around the table today talking about unconventional monetary policy and whether or not there's something that they can possibly do if the economy weakens. They don't think it will weaken, but they recognize that it might. And so if you think about that rumor or all of the discussion is going to be about what should we do with the Federal Fund's rate approaching zero when inflation continues to drop, raising real interest rates and creating risks of cumulative weakening in the economy. That's exactly the kind of situation that Japan faced and where fiscal policy is the obvious answer. That's what's really called for to get the economy moving. And the problem is with the opportunity, we spend trillions on tax cuts and wasted the opportunity to really get the economy moving by designing fiscal policy in the ways we've been saying that have been completely ineffective. And with massive debts looming in the horizon, we're exhausting all the scopes that we would want to have for future fiscal policy action.

So we face a risk of unusual times. We would want fiscal policies to be there to be used. And we're losing that opportunity. We're squandering it.

KATHERINE LEWIS (Newhouse News Service): We talked earlier about the policy implications of all the jobs that have been lost. But I'm interested in your take on the economics perspective. Of the three million or so jobs that were lost, how many of those are permanent victims of increased productivity or companies learning that they can get along with fewer workers?

MISHEL: There's a fallacy that faster productivity is responsible for these problems. But faster productivity is what economists are always hoping to accomplish to provide longer-term growth and improving the standard of living. So if we had higher productivity, the problem then becomes why are we not having sufficient demand to buy all the things that we can produce?

So I think it's sort of putting things wrong-sided to think that somehow the problem of the job loss is to faster productivity. Bob Solow said out of the recession in the past, we might have hoped for five or six percent growth. With the faster productivity, you know, we might even hope for more.

SOLOW: I think the notion that jobs are lost permanently is a mistaken one. Particular jobs disappear. But the need for labor is always there as long as we're not saturated with goods and services. Over hundreds of years, productivity in the industrial world has increased very rapidly. There has been no long-term increase in the amount of unemployment and there need not be now. We simply have more room to expand if we can improve our productivity. To blame productivity increase on unemployment is biting the hand that feeds you.

KATHERINE LEWIS: Maybe I phrased the question wrong. What I'm really trying to get at is the three million workers out there who are now unemployed, do they have a hope of getting new jobs? Or are we kind of going to see a permanent long-term higher unemployment rate?

SOLOW: That depends entirely on our policies, on public policy, and to a certain extent the luck of the draw. But it is not written in any way that that job loss is permanent. We could produce -- I haven't done the numbers in the summertime -- but we could produce perhaps six or seven percent more than we are producing now. We could by virtue of the fact that we have labor to absorb and rather high productivity at the moment. What it takes is a business cycle revival helped, not hindered, by public policy.

SPERLING: This is Gene Sperling. Can I just say that I think one thing that people don't realize sometimes is that between '93 and '2000, there were over 22 million jobs created during that time period. Yet, during that time period, there was a lot of so-called churning. Lots of jobs were lost. Lots of job categories did go to other countries.

The point was we had a vibrant economy. There was strong productivity growth and there was job shifting. But we were replacing new jobs, high wage jobs in new industries. So I think there's a bit of a misconception that because one might see high productivity and some job loss that that is the cause.

I was saying that I think that rather than looking at the productivity causing job losses is that there was over excess capacity. People had to pull back at the same time, companies feel competitive pressure to still keep modernizing. So you can see productivity gains even as they're pulling back. But I think the point is that when the economy operates as it did in the '90s, you are seeing people lose jobs. They're not regaining those particular jobs. And there are some job categories that are being somewhat shifted. But because there is so much strong growth and new innovation there are other jobs taking its place. So that you're having net job gain. And that is what we saw in the '90s. And that should be our aspiration for the rest of this decade.

It may be that many of the people who lost those jobs aren't just on layoff waiting to get them back. They may have lost those jobs permanently. But the real question is will the economy be creating comparable jobs at comparable or higher wages that they can easily move into as was often the case in the '90s?

GAIL CHADDOCK (Christian Science Monitor): We've talked to most of this Congress as a branch of government either didn't exist or wasn't important. But they're sitting on hundreds of billions more tax cuts in Congress, hundreds of billions in more spending. What would you suggest that the Congress do with the choices they're looking at?

SPERLING: We've gotten very used to this completely partisan operating on the budget where we just expect the administration to continually push for expansive tax cuts that will have long-term fiscal impacts.

But if we could get back to more a bipartisan-type of approach, then I would recommend that there be a pulling back, a freezing, moderating of at least tax cuts for people in the top few percent. And that those long-term savings are what will matter most for our long-term fiscal ability in terms of dealing with Social Security, Medicare and that increases savings.

And to the degree that then some extra funds were used now as we discussed to give state relief or to even, you know, to give state relief or some form or temporary job hiring incentives or unemployment insurance, that temporary extra increase in the deficit would not be harmful to our long-term fiscal future. Because it would be one time. And it would be done in the context of improving long-term fiscal situations.

So what I'd recommend is that there be a bipartisan effort to moderate the tax cuts going forward so that we can restore long-term fiscal discipline. And then that would free up our ability to have a one time relief to reduce the amount of taxes that are being raised at the state levels, education spending cuts that are taking place, and to help many of the unemployed people who if you put a dollar in their pocket, they are the most likely to spend a dollar immediately and help stimulate the economy.

TOM HEALY (Counterpunch): I'd like to get to the nation's governors. They will be meeting in Indianapolis this weekend. And they're bearing a lot of the fiscal responsibility that the panel is suggesting the Bush Administration has abdicated. What would the panelists suggest to governors who are facing cuts in education or forced to raise taxes or to absorb the cost of under funded federal projects like the Super Fund cleanups and the Safe Drinking Water Act, things like that?

SOLOW: Complain bitterly.

TYSON: I would say that a very potential force here. But I don't see it happening. If the governors who do share a very serious common problem were to raise their voices in unison across party policy lines, I could imagine that one action that might occur in the months leading up to the election would be some more significant support for the state.

And frankly, I think that because that would be temporary and well targeted. And because the state cuts are actually overwhelming for most Americans, any benefit of the tax cut they're getting -- which is very small -- politically it's a very powerful thing that the Bush Administration can do for itself. But it won't do it unless it is lobbied heavily by the state governors both complaining bitterly, as Bob put it, and also calling for serious action. That's the only action I think I could imagine that might be beneficial in the next several months, that is also politically likely to be taken.

A lot of other things we've talked about today might be very wise from an economic point of view. I don't see the politics at all for any of them. So, this one is at least politically within the realm of possibility. But it would have to come from a very strong effort by the governors across party lines. And I don't see any evidence of that at this moment.

TYSON: Incidentally, I just want to emphasize for the non-Californians on the call part of the reason, a large part of the reason for the problems in California. The state government has both a balanced budget amendment and a two-thirds voting rule.

It also has Proposition 98, which means a lot of the spending which the state might want to cut, it's forced to fund because of the local and county initiatives. It has the necessity of covering Medicaid, which for most states at this point is the most rapidly rising or the second most rapid.

If you're in the state where you can't even get a political compromise to cut those things against the poor and the middle class, then you're really stuck. You're stuck with essentially no possibility out of this massive deficit. And that's exactly where California is, which is exactly what the recall is about.

JIM MCTAGNE (Barron's): Greenspan has said that tax cuts are fine as long as they are accompanied with spending cuts. The administration proposes limiting the growth and discretionary spending to four percent. Do you think that's enough? Or would you have another number in mind?

TYSON: Well, the problem with that is first of all it's not even enough. I mean, the problem with that number is that it leaves out Medicare issues, it leaves out the Social Security issues, and it leaves out the interest on the debt. And they leave out military. They leave out homeland security. The four percent is not enough for per capita adjustment. And we're starting in certain areas of the economy where we're under spending and have been under spending for quite some time.

SPERLING: No one has presented a plausible scenario for getting out of this fiscal mess through spending cuts alone. First, virtually 94 percent of the increases in spending in the last few years have been on things related to military, terrorism or international security. I would suggest that one ask those making that case for even a framework for how to do it. Because I believe it would show they would have to cut the entire government virtually in half. So it is simply not a plausible scenario. One cannot be for restoring fiscal discipline, be serious about being for restoring balanced budgets and simply want to take on the spending side unless they are aspiring to unprecedented draconian cuts in vital services.

TYSON: There's some good work on that I think by the Senate for budget priorities, sort of looks at the percentage of cuts. In some scenarios, I cited one in Business Week which I took from them which is sort of like in 2008 if you want to get a deficit figure, if the deficit were going to have $400 billion -- which I think a lot of people think we will in 2008 -- hasn't come down, you want to get the balance and you leave certain things off the table, you're with 80 percent cuts. I mean, the whole spending cut scenario just doesn't add up by fuzzy math or otherwise.

END TRANSCRIPT