



# Fiscal Policy BULLETIN

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## Current U.S. Economic and Fiscal Policy

*On September 21, 1994, Alice M. Rivlin, Director of the U.S. Office of Management & Budget addressed the annual meeting of the Indiana Fiscal Policy Institute about the economic and fiscal policies of the Clinton Administration to date and the outlook for the future. These are her remarks.*

I really appreciate being back in Indiana, where I feel at home and where I do feel one has to go for a reality check. I think one gets a little far from reality sometimes in Washington and needs to return to *real* places like Indianapolis to figure out what's going on.

Let me take this opportunity to say a few words about how things look from Washington. What is Clinton administration economic or fiscal policy? How are we doing? And most importantly, what may be the next steps as we move into our next budget cycle? The process of putting together the fiscal 1996 budget which we will send to congress the first week in February is beginning.

### Economic and Fiscal Objectives

Cast your mind back to what seems like a long time ago, to about two years ago at the time of the election. And then on into early 1993, as our team moved into Washington and took over...

The economy at that moment was not yet strongly recovering from the recession that had begun in 1990 and dragged on so long. More importantly (and it was the focus of the attention of the new team as we came in), not only was the economy

not growing strongly out of the recession, but the prospects for the longer run looked uncertain. There was a lot of fear about the economic future. The standard of living had not been rising for quite a long time. Polls showed that people were genuinely worried about how they would be living in the future and whether their children would live as well as they do. We were not competing that well in international markets, although enormous progress had been made by American companies in restructuring and getting back on the competitive forefront. There were large groups in the population falling behind everybody else, particularly those with low skills and little education. There was economic fear and a basis for those fears: lagging productivity increases and the consequent lags in wages, which I think propelled the Clinton Administration into office. There was also a budget deficit which was huge on anybody's scale, and to make things worse, it was increasing. As we did the projections, and nobody disagreed with us at the time, what we saw was that the budget deficit was unsustainable. We had to do something. It was going through the roof. And if we didn't make a drastic change of direction, we would have astronomically escalating federal deficits. Deficits had been high for quite a long time, they were



Alice M. Rivlin

draining off our relatively low savings (we're not a high saving country) into financing the government. This was unsustainably increasing, the service on the debt was increasing, and something had to be done. But, there was also a basis for hope. There was the business restructuring movement, which had been going on very seriously. There had been government restructuring. There was a consensus on the need to increase investment. There was certainly a consensus on the need to cut the deficit. There was a consensus growing on the need to complement increased private investment with public investment to

improve the skills of the labor force at the state level, at the local level, and for the federal government to do what it could do to improve our infrastructure by fostering science and technology and all of the kinds of investments that government can do to improve the long run economic future. And there was not a consensus I think, but at least a widespread view, especially in the business community that we had to have more open trade and that the North American Free Trade Agreement (NAFTA) and the General Agreement on Tariffs and Trade (GATT) had to be passed.

## The Deficit Reduction Plan

The economic plan was given first priority of the Clinton team. And from one who has struggled with budgets and plans for a long time, the gratifying part was that the new team focused very much on the fundamental, long-run problems. They focused on investment and how to get the deficit down. They focused on shifting what the government does more toward investment in the future: less consumption-oriented expenditures, more science and technology infrastructure, and skill building. We focused on running the government more efficiently. We knew it would be a very hard sell, to focus on the longer run problems and that the pay off would not be immediate. There was enormous cynicism about politics and government in general. I think a lot of us share that; we expect politicians to be crowd pleasers and to emphasize the short-run pay off, but we really thought we could not do that. Deficit reduction takes courage, it takes cutting into spending programs that people like and/or increasing taxes. We did some of each in the President's first plan, about half and half. We came up with a \$500 billion package. That's \$500 billion over five years. We hoped that we would, with a combination of tax increases and spending cuts, be able to reduce the deficit from what it would have otherwise been by about \$500 billion.

There was a lot of skepticism about that number. A lot of people said,

"That will never happen, these are overestimates, they're always overestimates." But that has, I'm gratified to say, not proved to be the case. I think there was some courage involved in tackling the deficit and perhaps some courage involved in tackling NAFTA and GATT. It wasn't just a question of political courage, there were some economic risks as well. It was a little dicey to be bringing the deficit down when the recovery wasn't strong yet. It was something of a gamble. But it was a gamble that we took and it has paid off well. The economy did take off strongly--largely thanks to the continued drop of long-term interest rates which had begun to head down and which dropped precipitously as we made clear that we were bringing the budget deficit down. They have gone back up again which is not surprising as the economy took off. I think it is somewhat worrisome in the sense that if we are to encourage investment for the long run, we can't have long-term rates too high. Unemployment rates have come down, inflation has not escalated yet, and the outlook while mixed (certainly one would expect some escalation of inflation at this stage of the business cycle) is really very gratifying.

Growth has been strong, more than four million new jobs have been created. Are these good jobs? Some are and some aren't, that's always true. It depends on how you look at the numbers. I saw some numbers yesterday that I found very interesting. If you look at the new jobs created by large sectors of the economy, you see that the preponderance of jobs created have been in the service sector, because that is the sector that is growing. And on the average, service sector jobs pay less. But if you look at this by occupation, it's rather more encouraging. These are jobs at the higher end of the occupation scale. Jobs that demand more education, more technology, and more managerial skills that have been increasing even within the service sector--and that is encouraging.

We have made real progress in downsizing the government. Nobody

ever believes that, there is enormous skepticism that anybody can cut government payroll. We are doing it. We are doing it in part because we said we would and because Congress took it as our word and put it in the law. So now we don't have a choice. We have to meet the target of downsizing the federal workforce by 272,000 people over a five-year period. We are getting there. It's not fun. It is very difficult. But state governments have done it and there is no reason why the federal government can't do it and we are.

## The Next Step: Tackling Entitlement Programs

So far so good. We are rather pleased with the record. But clearly the business cycle turn around has made the short-run success possible and has made it look good. What about the longer run? We have brought the deficit down and if our projections hold, it now looks as though the reduction from the baseline as we say, from where we would have been, will be not \$500 billion, but more like \$700 billion. Now, that's not peanuts, that is \$700 billion of debt that we are not passing on to our children and grandchildren. The deficit in the year that we are about to move into, fiscal 1995, we are now estimating at \$167 billion instead of the well over \$300 billion that it would have been on the projections two years ago.

However, \$167 billion is still a fairly large number and the bad news is that the deficit, unless other policies are changed, will not continue to come down. It may come down a little more, especially if the economy does well, but the projections show it getting stuck at somewhere between \$150 and \$180 billion. Why is that, if the economy is presumed to grow? Well, I think everybody knows the answer to that. Some programs, particularly the Medicare and Medicaid programs, are growing fast, faster than revenues come in and when that occurs your deficit inevitably escalates. In order to keep on the path and keep focused on releasing the savings of our economy

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for private investment, we really have to keep the deficit on a downward path. How do we do that? Cut programs. Sounds easy. The main part of a budget director's job is allocating the discretionary part of the budget, about \$545 billion, about half of which goes for defense and half of which goes for all of the other appropriated programs of the government. That number we are holding hard and fast on. We have held it there for three years. The budget that we will put together in February will not change that number--it can't because it is in the law. We are operating under very strict budget caps. That is hard but it

doesn't solve the problem. It is already built into the projections.

It is this other piece, the entitlement growth, the health programs and Social Security which pose not a short run problem (Social Security is running a surplus), but a long-run problem as the baby boom generation begins to retire.

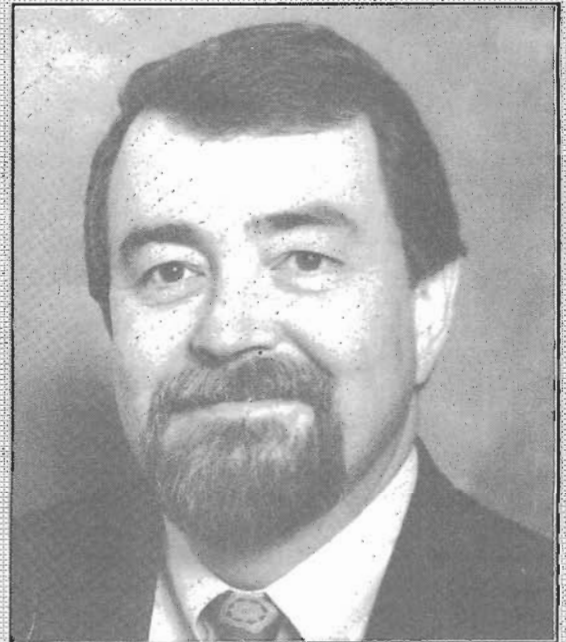
So it is this set of programs, Health and Social Security, that we will be focusing on most heavily over the next few months. We are obviously not alone. There is an Entitlement Commission appointed by the President and a thoroughly bi-partisan group headed by Senators

Kerrey and Danforth. There are groups all over the country looking at what we can do about the long run future of entitlements. I expect this to be the major post-election debate. It will not be an issue in the election per se. There have to be details. I don't expect you'll hear much of it from candidates on either side as they move into the election. But you will have to hear details from us as we bring our budget forward and you will have to hear it from the congress next year. These budgets can't be balanced in the abstract, they have to be balanced in the particular. It's not easy and this is what I expect we will all be talking about in the period post-November and well into the foreseeable future.

## Institute Selects William J. Sheldrake as New President

The new president of the Indiana Fiscal Policy Institute will be William J. Sheldrake, who will succeed Earl M. Ryan. Earl is leaving the Institute after seven-and-one-half years to become vice president-executive director of the Citizens Research Council of Michigan, an organization similar to the Institute, headquartered in Detroit. Mr. Sheldrake, currently deputy director of the State Budget Agency, will assume his duties on December 16. Mr. Sheldrake has served in various capacities in state government, starting in 1981 as chief fiscal analyst for the House Ways and Means Committee. In 1985, he moved to the State Budget Agency to become director of the Tax and Revenue Division. Earlier this year, he was appointed deputy director of the Agency.

Although Bill has broad experience in all aspects of state finance, his principal responsibility in recent years has been that of state taxation policy and forecasting state revenues, in which he has played a key role. Charles E. Schalliol, chairman of the Board of Directors of the Institute, said, "We are indeed fortunate to get an individual of Bill Sheldrake's ability and expertise. He is the premier expert on state fiscal policy issues in Indiana and is held in high regard by policy makers of all political persuasions. The Board of Directors feels very strongly that he will maintain and build upon the record of credibility and integrity that has characterized the Institute."



Bill earned both his bachelor's degree and his master's degree from Purdue University. A veteran of the U.S. Air Force, he is married and has three children.

*The Indiana Fiscal Policy Institute, formed in 1987, is a private non-profit governmental research organization. It is the only independent statewide source of continuing research into the impact of state taxing and spending policies. The Institute is privately supported by a variety of organizations, corporations, associations, and individuals in Indiana and surrounding states. Contributions to the Institute are fully deductible under section 501(c)(3) of the Internal Revenue Code.*

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At the recent annual meeting of the Institute, elections were held for officers and members of the Institute Board of Directors. The Institute would like to acknowledge the members of the Board of Directors and their organizations for their continued support. (New members in blue type)

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Charles E. Schalliol, Eli Lilly & Co., Chair  
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## Bruce N. Cracraft 1922-1994

Bruce Cracraft, the first chairman of the board of the Indiana Fiscal Policy Institute, died on September 18, 1994. Perhaps more than anyone else, Bruce was responsible for the creation of the Institute and initial establishment of the policies that have served it so well.

Bruce was with Indiana Bell for 31 years, retiring in 1986 as vice president and general counsel. A man of immense public spirit, he served numerous organizations in various capacities. He was, for many years, the chairman of the taxation committee of the Indiana Chamber of Commerce. He was also a director of Crossroads Rehabilitation Center and the Indiana Legal Foundation, in addition to participating in many other organizations.

Bruce will be remembered for the sound judgment and integrity with which he approached other people.

The Indiana Fiscal Policy Institute is indeed fortunate to have had Bruce as its first chairman and it is with a mixture of pride and sadness that we remember his contributions to this organization.

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**Indiana Fiscal Policy Institute**  
251 N. Illinois Street, Suite 980  
Indianapolis, Indiana 46204  
(317) 237-2890

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