
STANFORD UNIVERSITY
On the Record: Michael Boskin

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Counselor to presidents and governors, Stanford University's Michael Boskin is one of the most prominent members of that elite group of economists who work the terrain where theory meets the real world.

He is a go-to guy for Republicans -- and, from time to time, Democrats as well -- when it comes to making decisions on how government should tax, spend and borrow. A forceful advocate of low taxes and limited government, he's sat at the table as budgets are drafted and tax bills written.



Photos by PENNI GLADSTONE / The Chronicle

ON THE FEDERAL DEFICIT

"I think we primarily have a spending problem."

ON THE NEED TO KEEP TAXES LOW

"The worst thing in the world would be to turn the United States into France or Germany."

ON GOV. SCHWARZENEGGER'S BUDGET POLICY

"He took a horrible crisis and made it into something that was manageable."

Under the first President George Bush, from 1989 to 1993, Boskin was chairman of the President's Council of Economic Advisers. When George W. Bush ran for president in 2000, Boskin helped put together his economic platform. Later, Boskin and several colleagues from the Hoover Institution, the conservative think tank affiliated with Stanford, joined a council of experts that helped frame Gov. Arnold Schwarzenegger's economic policy.

Boskin is especially known for his work on inflation. As chairman of the Commission on the Consumer Price Index in the mid-1990s, he argued that the government's chief inflation yardstick overstated inflation.

He recommended modifications in the way the index is calculated that would have reduced cost-of-living increases in Social Security and other programs, changes regarded by supporters as prudent and by critics as callous.

Boskin earned his economics degrees at UC Berkeley and then crossed the bay to Stanford, where he has taught for more than three decades. The following interview has been edited for space and clarity.

Q: How is the economy doing?

A: It's been remarkably resilient. In the very short run, the economy has taken several hits. It's growing a bit more slowly, partly because of energy prices and the hurricanes. There's a whiff of inflation concerns. The best guess is we'll grow for a couple of quarters in the 2 percent range, down from 3.5 percent. We should see some modest improvement next year. We should get some benefits from the rebuilding of the gulf.

Q: What about such problems as the nation's low savings rate, the federal budget deficit, the trade deficit?

A: The trade and budget imbalances are issues. The current account deficit (the broadest measure of the nation's trade and related deficits with the rest of the world) can't be 6 percent of GDP forever. But there's no need for it to reverse abruptly and end in a hard landing.

There is an excess of saving in the rest of the world relative to the domestic investment opportunities in Europe and Japan and the Middle East and non-Japan Asia.

Some of that is finding its way to the United States. Ask where would large amounts of capital be deployed in a place that's fairly safe and has good growth opportunities.

It would be hard to be more optimistic about the long-term growth of Europe or Japan than about the United States, given their even more challenging demographics and (the far more advanced welfare states in Europe, the combination of which will make it very hard for Europe to grow at any decent clip for the foreseeable future.

Q: What about the federal budget deficit?

A: It's important to get the budget on a path to balance, properly measured and properly accounting for the need for temporary debt-financed spending. A lot of the problem is that people focus just on the headline deficit numbers, and that can be very misleading.

Q: Is the United States living above its means, consuming too many imported goods and not saving enough?

A: We need to continue to work with the rest of the world to encourage their growth and their increased consumption and investment. We have a relatively low private saving rate, although official statistics understate the extent of the saving for technical reasons. I think we were working on these things.

We should be concerned. We shouldn't be complacent. But people who argue that we are on the verge of becoming Argentina have overstated things considerably.



Chronicle / Katy Raddatz

Michael Boskin, professor of economics and senior fellow of the Hoover Institution, addresses a presidential debate at Stanford. Boskin has been on the economic team of President Bush and of his father and has also been advising Gov. Arnold Schwarzenegger.

Q: How can we encourage Americans to save more?

A: One of the main areas we have been focusing on in recent years is the tax structure. The tax code has a complex series of incentives and disincentives to save. Cleaning up the tax code and making it less inimical to saving would be one area.

Q: Were President Bush and Congress irresponsible to allow the budget deficit to rise so high in the last few years?

A: The increase in the deficit from 2001 to 2003 was probably the best-timed counter-cyclical fiscal policy ever. It helped the economy. It shortened the recession and made it less severe. Fewer jobs were lost. The natural resilience of the economy, an aggressive monetary policy and an aggressive fiscal policy made what could have been a very ugly situation far less severe.

Deficit finance exceeded tax revenue in World War II, but we left a safer world. War and recession are the times you want to debt finance. The notion that deficits are bad is way too narrow. Deficits can be a serious problem over the medium and long term. There are times it's good to see the deficit worsen or the surplus turn into a deficit. We would not want to raise taxes or cut spending abruptly in a recession. You'd worsen the recession.

The idea was to get the budget moving back toward balance, to get the deficit cut in half. The president was on that path until the last few months, and then, of course, we got hit with the hurricanes.

Seeing through the short-term storm, the president and Congress have to get back on a path to getting the budget back in balance. There is obviously going to be a large amount of one-time spending.

The deficit highlights the need to get some tighter cost/benefit criteria applied to government programs. I think we primarily have a spending problem.

It would be a good thing if we moved the budget back into a situation where, over the medium term, it did not increase the ratio of federal debt to gross domestic product. That would be a deficit in the 2 percent of GDP range. We ought to be heading back there once we're through the short-term turbulence of the hurricanes.

Q: The Economist magazine recently wrote: "Mr. Bush has increased spending more than any president since Lyndon Johnson and cut taxes with the enthusiasm of Ronald Reagan." Is that accurate?

A: It's probably an exaggeration. Some of this was thrust upon him -- the need for homeland security spending, Katrina, some of the terrorism spending. There was a widespread view that we had to rebuild the military.

Still, we're probably spending too much, on balance. The way I tend to think about these things is to net out needs for temporary expansions and contractions.

Net of that, I think the record on spending is better. The major big expansion has been the addition of the prescription drug program in Medicare. The major alternative was not doing nothing, but a still larger program that the president's political opponents had proposed.

The drug benefit is large. It has some good reform elements in it. But it was unfunded and will be added to budgetary pressure starting next year. And we'll have to figure out how to pay for it.

Q: Does it make sense to push for making tax cuts permanent now that the economy is solidly expanding again?

A: My own view, strongly held, is we all have a very, very large stake in having a modest -- not a large -- hand of government in the economy. There are many reasons why we are more successful than the Europeans or the Japanese over the long term. I don't want to put all of it on taxes and spending and regulation and so on. But surely the policy does matter.

It is a lot better to have an economy with 4.9 percent unemployment than an economy with 11 percent unemployment. It is much better to have an economy that tends usually to grow in the 3 to 4 percent range than one that usually grows at 1 to 2 percent.

We're going to have to keep taxes modest. And that's going to require some rigorous control of spending and entitlement reform. The president had it about right in the package he was trying to put together. Getting the debt-to-GDP ratio stabilized over the next few years is the right thing to do. It will be at levels well below Euroland and way below Japan -- not a level that needs to cause any alarm.

But if we never have any spending control, if there is never any rigorous testing, never any relooking at programs, but we just keep adding and the public sector grows faster than the economy, that may satisfy other needs, but our collective interest in a more vibrant economy, a more rapidly growing economy generating more jobs and incomes, will be set back considerably.

The worst thing in the world would be to turn the United States into France or Germany. That's a recipe for economic and social disaster.

Q: Couldn't a rational person argue that maybe you trade a little bit of economic growth for providing health care to all citizens, improving public education, building public infrastructure and reducing income inequality?

A: That's certainly a legitimate point of view. But there are two issues in it. What is the potential trade-off? How severe is it? And secondly, what programs are likely to produce outcomes in the real world?

The record is at best mixed. We spend immense amounts on education in the United States. The places where there is the largest spending per pupil have the worst schools -- New York City, for example. You've got to look for ways to make the public sector more efficient. When you just throw money at problems, it greatly reduces the pressure to do that.

Q: Can we afford to cut taxes when there's a war in Iraq?

A: I think it is sustainable for a few years. There was a much more rapid buildup of the military under Reagan. People whom I respect a lot believe that was a big part of the reason the former Soviet Union wound up going peacefully. In retrospect, it proved to be a very savvy investment.

Looking just in the short run can be very misleading. If this was going to go on for 25 years, then a much higher fraction of it should be taxed than debt-financed. If you think of it as something that's going to be a few years, then it makes sense primarily to borrow the money and spread the cost. That avoids wild swings in taxes.

Q: Are you a candidate to replace Alan Greenspan as Federal Reserve chairman?

A: I have given my suggestions. There are several very good people. I'm sure the president will find somebody who is an able successor to the very tough shoes to fill on Alan Greenspan's departure. The people who I have recommended are people who are being talked about.

Q: Do you believe that housing prices are in a bubble?

A: In some geographies, there is a minibubble. The Bay Area has been one of them, particularly at the higher end. That is starting to unwind a little bit. I don't think it needs to be a collapse, but I think you won't see housing prices rise as rapidly. They will flatten or maybe decline slightly in some geographies.

Q: Is the rise of a housing bubble the Fed's fault?

A: You have to go back to why the Fed lowered interest rates so aggressively and kept them low for such a long time. If you go back to the bursting of previous bubbles -- the 1929 stock market crash and the Great Depression, the bursting of the Japanese stock market and land market bubbles -- all the analysis, the history, suggests that the cost of allowing the economy to degenerate, and especially to allow the risk of outright deflation to occur, (carries) with it such substantial costs that it was worth taking out some extra insurance. The aftermath of the bursting of the bubble, as well as 9/11, the corporate

scandals, as bad as they were, were much less severe than they otherwise would have been.

Q: How high do you think the Fed will go in raising rates?

A: They are going to go two or three more times. Going far beyond that would imply that we had a lot of inflation pressure that was unlikely to be purely temporary, that the inflation pressures from energy prices were spilling over into a lot of other commodities. That bears watching. Who else is going to be concerned about inflation if not the central bank?

Q: Are you worried about the growing gap between rich and poor in the United States?

A: Widening income inequality is an issue, not primarily because it's less equal, but because you'd like to see people at the bottom do better. The primary focus of most economic policy, especially at the federal level, ought to be on maximizing noninflationary growth.

A rising tide may not lift every boat, but it lifts a lot more than any other. If we, in pursuit of these other goals, wind up with an economy that looks like France or Germany, we will wind up having done the people we are trying to help a disservice.

There's been a widening gap based on education. So should we be trying to figure out ways to get more disadvantaged people not only into, but successfully completing college? I would be in favor of activity designed to do that at the federal, state and local level that was likely to succeed.

Q: You're not just a theoretician. You're also a policymaker, aren't you?

A: I have advised every governor of California and every president of the United States since the 1970s, with the exception of Gov. (Gray) Davis.

Q: And look what happened to him ...

A: I will leave it to you to draw the obvious correlation.

Q: And look what happened to the first Bush in the White House. So it comes around both ways.

A: I'd be happy to talk about that, by the way.

Q: What are you doing for Gov. Arnold Schwarzenegger?

A: Gov. Schwarzenegger put together a group that George Shultz chairs. We talk about the state of the California economy. We've been looking at how the state got into the

mess it got into, a situation where revenues rapidly rose and it all got spent and built into the baseline and got into this kind of unsustainable fiscal mess.

Q: Schwarzenegger has famously taken taxes completely off the table in dealing with the state's fiscal situation. Is that wise?

A: Thus far, it's been quite successful. He inherited a horrible mess, he dealt with some of the most pressing short-term problems, and he has put us on a path to dealing with this. He's managed to get some control over spending. We refinanced the inherited debt in a more sensible way.

Revenues are growing. The projections show still further increases on very reasonable economic assumptions. He's taking that extra revenue and devoting some of it to some key needs in transportation and education. But some of it is going to more rapidly pay off the debt.

There has been a surge of revenue for a year or so, as the economy has done a little better than people thought. He wants to have a prudent management of that and not just spend it all.

There are a variety of ways to deal with taxes and spending and deficits, all of which depend on the state of the economy. Republicans tend to believe that, if you limit taxes, you put some pressure to limit spending. And there is some validity to that. It's important to limit the tendency for automatic growth to go on without thinking whether you're getting very much back for the bucks you're spending.

The notion that anytime there is a budget imbalance to go to raising taxes is wrong. You wind up with a ratcheting up of the role of government over and over again. And you wind up as a France or a Germany, or California's version of that.

If you look at what happened in the 1990s, Gov. (Pete) Wilson put in some very strong spending controls. By the late 1990s, those had dissipated. We had a bubble concentrated in Silicon Valley. We had massive gains in capital gains revenue and stock option income.

Gov. (Gray) Davis and the Legislature spent almost everything. Now you try to get that to something reasonable, even if it is more generous than in 1997, you're cutting, and (critics say) you can't do that, it's unfair. The whole vocabulary that has developed to talk about taxes and spending in the budget in Washington and in California is not the kind of vocabulary that is conducive to intelligent decision making.

Q: Should California be taking on so much debt to pay its expenses?

A: Gov. Schwarzenegger inherited tens of billions of dollars of short-term debt. He refinanced it, and it's on the road to being paid off. We took a horrible crisis -- he took a horrible crisis -- and made it into something that was manageable, something that could

be worked through. It would not have been possible -- the credit rating of California was below that of Puerto Rico -- to have financed the spending. He had to play hardball with the Legislature. Now, he's trying to deal with some of the structural issues that have a lot of spending on automatic pilot.

We're going to have to control the growth of spending in virtually every category. It doesn't mean spending can't go up. It just means it can't go up as rapidly as is projected. Limiting overall spending to the growth of population and inflation would over a few years, with the current tax base, solve the problem.

Q: What's the difference in views between you and a liberal economist such as San Francisco Federal Reserve Bank President Janet Yellen?

A: I know and like Janet. On many things, we would agree. On the need for strong, noninflationary growth, we would be dead on. That the Fed needs to be very careful about leading to a climate of price stability, we would be totally in agreement. On that taxes can get too high and cause problems, we would agree. On the need to have a social safety net that's humane, cost effective, we would agree.

Where we would probably disagree is on how limiting to growth and prosperity and low unemployment taxes are as they get higher and higher. There certainly are some people who the press describes as liberal Democrats who worry about it less than I do.

On the effectiveness of some of these programs, I think we want to try to get assistance to people who need it, I think we would agree on that. On what actually happens in the political process and what fraction of those dollars actually serve that goal as opposed to just going out there and getting spent, we probably would disagree.

Q: Isn't it ultimately more a question of values than facts?

A: It's not just values. It's a question of how the economy operates. I think we have really strong natural experiments. If we move from our level of spending and taxes to that in Western Europe, there's no doubt in my mind that the probability that we would be worse off is 100 percent.

There is tremendous value in trying to represent the collective good, the collective value to everybody in our society of having a modest role of government and trying to force serious social cost-benefit analyses on spending decisions, keeping tax rates as low as possible, regulating where we need to but making it as flexible as we can, reining in excessive lawsuits, having open but rules-based trade, sound monetary policy -- that's the prescription.

The costs of not doing that -- maybe not instantaneously, but over time -- are immense.

Beyond the boardroom

What is your morning routine? I read four newspapers (The Chronicle, San Jose Mercury News, Wall Street Journal, New York Times) over breakfast. I often have an early teleconference.

How do you recharge your batteries? Tennis, skiing and sports in general. Reading and discussions with interesting people.

When do you do your best creative thinking? After dinner, when there is less interruption.

What is the best professional decision you have ever made? Choosing economics over law, starting my career at Stanford and returning to Hoover and Stanford when I left the White House, which provided continuous intellectual stimulation from great colleagues, terrific students, interaction with Silicon Valley, wonderful San Francisco Bay Area.

What was your biggest mistake? I've made too many to choose one.

What are you currently reading? David McCullough's "1776."

What is your favorite vacation spot? We love everywhere we travel, domestic and international, for the variety, but if we had to choose one, Italy.

Briefcase

Name: Michael Boskin

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Education: Doctorate, master's and bachelor's degrees in economics, UC Berkeley

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