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## Thus Does the Economy Grow

*By Keith Hennessey*

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The American people did not give power to congressional Republicans; they took it away from congressional Democrats. Republicans now have an opportunity to prove that they deserve majority status — that they can operate not just as an opposition party, but as responsible leaders who are willing to make hard choices and solve problems.

The goals of an ideal economic-growth agenda are simple and well known: a large and thriving private sector and a small government; reduced government spending, which means lower taxes (or at least not higher ones) and smaller deficits; open trade and investment; taxes and regulations that don't distort decisions, discourage capital formation or work, or provide rents to the politically powerful; deep and flexible labor markets; a reformed financial sector that channels savings to where they can do the most good; a society in which education and innovation flourish, and the most talented people in the world want to become Americans; a stable, low-regulation legal environment, in which monetary policy is sound and business decisions issue from customers and competitors rather than regulators and judges.

Practical policymaking is about moving incrementally in the right direction rather than trying to achieve the ideal all at once. It's easy for elected officials to distract themselves with simplistic partisan fights that are politically advantageous but either make little headway toward the goal or distract from more important underlying problems. Progress on a practical growth agenda requires recognizing the limits of policy and taking political risks.

Here, then, are ten practical tips for elected Republican officials, who are torn between trying to govern as a majority party and trying to oppose President Obama's agenda as a minority party.

**One.** *Prioritize medium-term problems caused by the government rather than trying to push businesses to expand more rapidly.* The economic-deleveraging process is painful, slow,

and necessary. Tools to mitigate the pain or accelerate the recovery have failed. So, refocus: Stop trying to mess with the economy's natural process of rebalancing. You're only making it worse with unintended consequences. Don't restore the homebuyer tax credit or try to put a floor on housing prices. Instead of stimulating particular types of investment, or encouraging businesses to hire, or searching for chimerical shovel-ready projects, spend your time fixing the medium-term problems caused by flawed policies. It takes political courage to admit that the short-term economic-adjustment process will be slow and painful, but additional policy distortions will only make things worse.

The government needs to worry less about the private sector and get its own house in order. There is plenty of work to be done: cutting government spending; preventing tax increases; replacing the failed Fannie Mae and Freddie Mac with a competitive private market; enacting free-trade agreements with Colombia, Panama, and South Korea; and undoing the worst regulatory excesses of the past two years.

**Two.** *Set the right goal: creating the conditions for growth rather than trying to create growth.* Policymakers need to get the policies right and let business leaders decide how to run their firms. Corporate leaders are sitting on unprecedented piles of cash, waiting to see what Washington will foul up next. Take Washington out of their decision-making by creating a stable, predictable, low-cost business environment. They will then decide how best to hire, invest, and expand. Your job as an elected official is not to create economic growth or jobs, it is to create the conditions under which the private sector creates growth and jobs. Stick to your lane and let business leaders stick to theirs.

**Three.** *Spending is now even more important than taxes.* Every dollar spent by the government comes from current or future taxes. If you focus your legislative energy on keeping current taxes low and do nothing to slow future spending growth, you merely shift taxes to the future. Without a spending-reduction plan, a "no-tax-increase" strategy is incomplete. Don't let the president raise taxes now or ever, and develop your own credible and specific spending plan. Convince voters, taxpayers, business leaders, and investors that, if given more power, you would use it to solve our entitlement-spending problem. Paul Ryan's "Roadmap" is a good start — federal spending should not exceed 20 percent of GDP. (I'd prefer much less.)

**Four.** *Don't waste all your time on nickels and dimes and process reforms; instead, slow entitlement-spending growth.* Yes, it's good to cut stimulus spending. To eliminate earmarks. To cut discretionary spending back to 2008 levels or lower, and to wage the usual Left-Right appropriations battles. These are important for restoring confidence in government, for undoing some of the worst spending excesses of the past two years, and for atoning for Republican spending sins. Such actions will be popular with many who voted to remove Democrats from power. Yet they are quantitatively insignificant in the long run.

With the retirement of the first baby boomers, the demographic wave begins to swamp us. Further delay of entitlement reform guarantees that tax increases will become part of a future solution. In Greece and France, citizens rioted because their benefits were being cut. In America, the new political force wants smaller government. Ignore the AARP's bleats and tell the truth about Social Security, Medicare, and Medicaid. We must make new, more modest, sustainable promises to younger workers, who already know that the old promises are bogus.

We should raise the eligibility age for collecting full benefits to keep up with demographic changes. We should transform these programs from forced-savings vehicles into strong safety nets that protect future seniors from poverty. We should tell younger workers that they must start saving now to supplement that safety net, and that they will be responsible for a greater portion of their retirement and health-care costs than their parents and grandparents were for their own. We should apologize to these young Americans and their children for waiting so long and letting it get this bad, and we should permanently restructure these programs so that government does not expand over time.

Some Republicans will want to duck this political risk, to shirk their responsibility and instead fight about millions in outrageous earmarks rather than hundreds of billions in popular entitlement promises. Because we have waited too long to act, we must now either grasp the nettle or allow America to drift into European levels of taxation. Any congressman who rejects the Roadmap and refuses to propose a quantitatively comparable alternative is implicitly endorsing massive future tax increases. That's irresponsible and anti-growth. The politics of this issue are hard but the decision should be easy.

**Five.** *Tax levels and tax structure are both important, but levels are a higher priority.* Republicans and conservatives love to debate the ideal tax reform. Structural reform is good, necessary, and very hard to enact. By all means push for an improved tax code, but not at the cost of higher tax levels or of failing to develop a credible long-term spending plan. A perfectly structured tax code that collects 25 percent of GDP is worse than a flawed tax code that collects 18 percent of GDP. Beware the siren call of the money-pump VAT.

**Six.** *Don't delink income-tax rates.* The strategy we developed in 2001 and 2003 worked. Forced by reconciliation rules to sunset the tax cuts, we set them all to expire on the same day. President Bush reframed the top income-tax rates as small-business tax rates. This argument won the day in 2003 and 2010 and will win again as long as the expiration dates remain synchronized. Don't fall for the trap of temporarily extending the top rates and permanently extending the others. This would guarantee future increases in the top rates.

**Seven.** *Offer to help the president expand free trade and open investment.* Rebuild the center-right free-trade coalition. The president will need to deliver a few Democrats to offset

the protectionist Republicans (darn them). You can fight economic isolationism, raise American standards of living, help American allies in Latin America and Asia, cooperate with the president, and split congressional Democrats. That's a five-part win.

**Eight.** *Offer to help the president fight the teachers' unions and improve elementary and secondary education.* You agree more than you disagree with the president on education. He has shown a limited willingness to take on the teachers' unions, and you need him to deliver Democratic votes to overcome a Senate filibuster. Encourage the president and reward him when he takes these risks. Prioritize education-reform legislation and pull him farther than he's willing to go. Treat this as an opportunity for imperfect incremental improvements in law rather than perfect message bills that die in the Senate. Education is a long-term economic issue of paramount importance.

**Nine.** *Now that cap-and-trade is dead, build a supermajority to stop the EPA from pretending it is a legislature, and then cut a deal.* After the Copenhagen implosion and the death of a domestic economy-wide carbon price, the president cannot block the EPA from fouling up the economy without something to show for it. Offer a little more money to further subsidize carbon-reducing-technology R&D in exchange for legislatively stopping the EPA from taking over much of the economy. Its unchecked use of regulatory authority would create uncertainty and be a significant threat to future economic growth.

**Ten.** *Lay the groundwork for repeal of the Obama health-care laws in 2013.* Develop multiple alternatives. Pass repeal in the House. Pressure in-cycle Senate Democrats to take a stand, and make repeal a centerpiece of the 2012 policy debate. In doing so, stop playing the Medicare card. While the health-care legislation cuts Medicare spending in the wrong way, to prevent fiscal disaster we need even more Medicare and Medicaid cuts than were enacted in those laws. If you use Medicare to scare seniors and repeal Obamacare but, as a result, cannot address Medicare's unsustainable spending path, you have made things worse, not better.

It will be tempting to cherry-pick the easy partisan fights from this list and postpone the politically risky elements for later. Republicans should instead treat voters like adults. Explain the mess we're in and stress that the solutions will not be painless. Show the American people that you deserve the responsibility provisionally granted to you.

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