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# RAHN: Recouping the golden quarter

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Good news - there is a relatively painless way out of the gov -ernment spending and deficit mess that Congress and the administration have gotten us into. Also, the apparent collapse of the disastrous health care and cap-and-trade bills might give enough breathing room for economic sanity to return. In my two previous commentaries, I described the calamity that will befall us if spending and deficits are not sharply curtailed. The following briefly portrays a politically doable way to right the economic ship:

In the nine quarter-century periods since the American republic was founded in 1789, the one with highest economic growth and job creation was the period from 1983 through 2007. Particularly remarkable - there were just four quarters (out of 100) of negative economic growth in that entire interval. That period of time was characterized by a reduction in government spending from 23.5 percent of gross domestic product (GDP) to 20 percent (the low point was 18.4 percent in 2000), and a reduction in marginal tax rates. Despite the reduction in tax rates, tax revenues both in absolute terms and as a percentage of GDP grew in the 1983-2007 period because of the improved work and investment incentives. As a result, the deficit fell from 6 percent of GDP in 1983 to just 1.2 percent in 2007.

For many years (until 1983), the Federal Reserve implicitly followed the Taylor Rule to guide monetary policy, which gave the United States both a falling and relatively stable rate of inflation. (The Taylor Rule is a formula that provides central bankers with information about whether they are creating too much or too little money.)

During that golden quarter-century, both the presidency and Congress switched parties a couple of times. Thus, it should be politically possible to go back to the policies that gave us the golden quarter. Most people understand that if the government is growing faster than the economy (as it has been for the past two years) disaster ultimately will occur, but if the economy and the private sector grow faster than the government, as they did from 1983-2007, almost everyone can be far better off.

First, the growth in federal spending needs to be frozen. This is not impossible. President George H.W. Bush in 1988 ran on a platform of a "flexible freeze" in spending and "no new taxes" and won by a large margin. His failure to implement the policies on which he was elected was, in part, responsible for the mild recession in 1991 and his subsequent defeat. After the election of the Republican Congress in 1994, during the Clinton administration, the growth in federal spending dropped sharply as a percentage of GDP. The election of Sen. Scott Brown and the Tea Party movement are indications that the American people understand more than their leaders that spending growth must be stopped.

It is expected that President Obama will announce a partial flexible freeze of federal spending in his State of the Union speech Wednesday. To be meaningful, it is important that the freeze cover all discretionary spending and be applied to the level of spending before the "stimulus bill." If the freeze is applied to the amounts allocated for spending after the bill, it would be a charade and would result in spending being a much larger share of GDP. Remember, the stimulus bill was supposed to be a one-time event and not to establish a new base level for spending. A flexible freeze means that some departments and functions would be allowed to grow in real terms (after adjustment for inflation) if others were reduced. Defense spending should be included in the flexible freeze. If we need to spend more on defense and homeland security, other, less essential and/or useless programs should be reduced by the same amount.

The so-called mandatory entitlement programs, particularly Medicare and Medicaid, are the big problems because the political class has yet to explain that not everyone can have all the free health care he or she wants. Health care must be rationed by price, by queuing (as is done in Canada and the United Kingdom) or by which condition is treated (as is done in most countries). There are no other choices. Perhaps what is needed is a bipartisan commission charged with making recommendations as to how to limit Medicare and Medicaid spending without increasing taxes. Independent policy organizations, such as the Cato Institute and the National Center for Policy Analysis (NCPA) have developed economically sound and politically practical proposals for dealing with these problems, which can be found on their respective Web sites.

As can be seen in the accompanying table, most big federal spending items have not been growing as a percentage of GDP and, despite the doomsayers, America was not left with millions of starving, sick people in the streets during the golden quarter.

Congress and the administration also need to reverse course on trade and stop and remove their protectionist acts. During the golden quarter, the movement was far more free trade and less protectionist, despite a few temporary, foolish, restrictionist measures.

As noted, the golden quarter was characterized by a long-term trend toward lower tax rates. The current Congress and administration have been enacting tax increases and proposing many more, which will only cause more economic misery. Many tax rates, particularly on capital, such as the capital gains tax and corporate income tax, are well above their revenue and welfare-maximizing rates and should be reduced, not increased.

Finally, America needs a return to a predicable and sound monetary policy. A good start would be to replace current Fed Chairman Ben S. Bernanke with John Taylor (the economist and former Fed member who developed the Taylor Rule a couple of decades ago). It would be a wonderful signal to the markets that economic sanity is returning.

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