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POLITICS AND THE POLITICAL ECONOMY

Speaker: KEVIN PHILLIPS*

American Academy of Actuaries' luncheon speaker Kevin Phillips is one of the most astute forecasters of political and economic trends in the U.S. today. In the 1960s, his book, The Emerging Republican Majority, correctly predicted the coming conservative era in U.S. politics and he coined the term "Sun Belt." Phillips is an expert on the politics of health care reform, the frustration of the middle class, politics, and the financial markets. His predictions and analyses are detailed in his newsletter, American Political Report. He frequently contributes to The New York Times Magazine, The Washington Post, and The Harvard Business Review.

MR. CHARLES A. BRYAN: As President of the Academy, I'd like to welcome Kevin Phillips. Kevin Phillips is one of the country's most astute forecasters of major political and economic trends. He has been an insightful observer and an influential commentator on the national political scene for nearly 30 years. In the 1960s, he wrote *The Emerging Republican Majority* in which he coined the term *Sun Belt* and foresaw the current Republican conservatism, nearly 30 years in advance of its occurrence. I know that his insights will help us understand how the Academy can be most effective in its work on public policy issues. Following his address, Kevin has graciously agreed to entertain questions and provide answers.

MR. KEVIN PHILLIPS: As is sometimes the case, when you entertain questions, you don't provide the answers. I will try to do a political version of risk assessment and risk analysis. I will take a look at the politics and the political economy we have and put some numbers around some of these trends, some of the parallels, and then some of the potential problems. I think this is a period of potentially very great upheaval and ongoing upheaval, not an upheaval that ended in November 1995.

One of the things that we, as a culture, tended to do in the last 20 or 30 years is term everything as a new revolution, and I think you can get carried away with it.

What I'll do first is go through a political overview of where we are now, and explain what are the predominant trends and frameworks to be watching. Second, I'll look at certain key issues—the budget, health, Medicare, tax, and pensions—in the context of what I think is a much weaker set of circumstances in Washington and in the new Congress. Many people realize this. Then I'll look at the politics of the business cycle. There is the politics of the possibly changing cycle of no longer being in the probusiness ideological cycle that began back in the late 1970s with various attempts to beat down some of the liberal legislation and the capital gains tax reform. I think this era is coming to an end, but it will have a great deal of significance, if that's the case. And then I'll wind up by looking at 1995–96 and the extraordinary politics that's out there. If you were to look at the age of the two parties, one is 170 years old and the other is 140. If they were people, they'd be dead. Some people think they have been

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on life support for a couple of decades anyway. I'll try to give statistics on where these parties and the party system are.

I wrote a book called *The Emerging Republican Majority*, which came out in 1969. It was used in the Republican campaign, and it basically said that the country was heading into a new cycle of Republican control of the presidency, and that happened. From 1968 to 1992, we had Republican presidents for 20 out of the 24 years. But in one respect, it was a very different cycle from many of those that had gone on before. If you look at this country's history, you'll see that we have had, beginning in 1800, roughly once a generation, a watershed election in which either the party out of power or a new party took over the presidency and dominated the presidency for between 75% and 85% of the time in the generation of the next upheaval. The numbers do work out, and it's a surprising pattern. And it was one of the patterns that led me back, in the late 1960s, to feel that the long generation was passing and that it was time for the upheaval, which was sketched in *The Emerging Republican Majority*.

Since that time, the pattern that we had under the Republicans was unusual in the sense that the most typical division of politics in the U.S. during that 1968-92 period was to have a Republican president and a Democratic Congress; that was the norm. So we had, for the first time, a pattern in which the change in the presidency did not go down, at least not enough. And, of course, the people who were now looking at the "Republican Revolution," say, "Well, now it's here; now we have it." Well, I don't think so. I think, beginning in 1992, there was the beginning of a pattern in which the U.S. no longer had unique arrangement of politics that other countries did not; we would have this roughly once-a-generation change and one party would be in the White House, and that would influence a great many things.

There was a longevity of the periods that matched changes in American politics and culture, and even demographics. I don't think that's going to be there anymore. What I think we're going to see is that 1992 kicked off a period in which these old institutional arrangements don't tie together any longer. The rule of thumb is not going to be a Republican president and a Democratic Congress. What we have right now is this extraordinary amalgam of a Democratic president and a Republican Congress, which we haven't had since 1947 and 1948. Since you all deal in statistics, as I do, let me give you some yardsticks to use when we start looking at the current polls on the present Congress and specifically on some of its budgetary and Medicare proposals.

The first thing to say about the Congress elected in 1994 is that this was the fifth time since World War II that we had a mid-term landslide where the party that had controlled Congress lost across the board anywhere from 4 to 13 Senators and anywhere from 45 to 55 House seats. This had happened four times before, so this wasn't the first time. It had also occurred in 1946, 1958, 1966, and 1974. The only one of those years that produced a Republican Congress against a Democratic president was the Congress elected in 1946. And what we've seen in these mid-term landslides is usually that the basis of this is public disgust with the president and his party, which also controls Congress. When that has been the pattern, which, as I say, is usually the pattern, it has been misread by the opposition. People were very unhappy with the president, but not really voting specifically for any carefully laid out policy agenda. And you can say, "well, this was laid out very carefully." Well, maybe it was laid out, but I bet that most of you voted, as I did, for a Republican member of Congress. I bet

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no more than 5% of you could have named the points in the Contract with America. I certainly couldn't have. I'm not sure I was wrong either. I don't think it was a mandate.

If you go back and you look at what happened to the Republican Congress that was elected in 1946, they really went off half-cocked. They rejected any idea of National Health Insurance, which Harry Truman wanted, and they really took a beating in 1948. They lost 75 seats in the House of Representatives, 9 in the Senate and the Democrats took control back. That will not happen this time. Even if the Republicans lose some, it won't be anything like that situation because people have a disgust with both parties.

With that backdrop of the Republican Congress, I'll read you a set of numbers. These numbers are very rarely carried in the press. I don't know why, because I do think it's true that the press is more liberal. But I think the press is very concerned about not having another immediate round of public disenchantment with Washington take over the news. The public is disenchanted with Washington, at least as much as they were before. Here are some numbers from *The New York Times'* Mirror Poll from December through the end of the summer. The question was, "Do you approve or disapprove of the policies and proposals of the Republican leaders in Congress?" December 1994: approve 52%, disapprove 28%. It was almost two to one. March, 43% approve, 39% disapprove; April, 44% approve, 43% disapprove; June, 41% approve, 45% disapprove; August, 38% approve, 45% disapprove. I cannot remember a new Congress where you had a change in party where the approval turned to disapproval so quickly and so substantially.

The thing that keeps this from being as immediately visible is we have a president who is not exactly fresh from a starring role in *Captains Courageous*. As a result, I don't think that the weakness of the Republicans has been the focus very much. But it's to the point to have this in mind when we get into the more specialized topical subject matter areas that I mentioned because you are not looking at a Congress that is cruising with big time favorable ratings. You're looking at a Congress that is not much more credible now to the public than the previous Congress. It's still regarded as being much too close to all the special interests of lobbyists and it could be much weaker if the president, who has profited from being at loggerheads with them (even though he doesn't do much), got tougher. The Republican coalition is not rooted in the sort of circumstance that has created past long-term majorities. I'm not saying it's another 1946, but it has lost approval levels quite significantly so far.

Let me now turn to the key issue areas. I'll talk about the budget, Medicare, health, taxes and the larger question of whether there is any coherent view of the pension system in the U.S. which, frankly, I doubt. Now the weakness I mentioned, in terms of the overall rating of the Republican Congress, should be taken as a backdrop for these specific areas. It's also quite possible to go through and look at specific polls on what people think is going on.

The budget is one of the most difficult areas from which to elicit public opinion because people are given to thinking that being against the budget is another way to condemn Washington and its interest groups. In a sense, that's right. But, as soon as they get deficit reduction masked with a popular program, then that abstract support tends to dissipate; that's also very true.

The New York Times/CNN Poll recently ran questions that spelled out, with not too much detail, even though it wasn't an unfair question, the basic divisions between the Republican proposals to do this in a shorter period with heavy Medicare cuts and the Democratic proposal to dawdle longer and not have as heavy cuts. And it showed the Democrats were actually up slightly from where they had been rated on the same question in June. Some 41% favored the Democratic approach, 19% favored the Republican approach, and 36% liked neither. The neither is hard to categorize with any precision, but it seemed to me it would mostly be people who just didn't think that a good case had been made for these things. They might think you can't trust Washington anyway and that both parties lie. That wasn't very well thought-out.

The Boston Globe has a very good chart and explanation of the chronology upcoming on the budget. The only thing wrong with it is, as they indicate, you really don't know what the polls are going to do because there's absolutely no precedent for this. The Republicans have never been in a meaningful budget summit or negotiation coming from a Congressional majority opposing a Democratic president. It has always been in other roles as the Republican minority getting in the way of a Democratic president or as the Republican minority or in the case of the Senate majority in the early 1980s semicollaborating with a Republican president. We have no idea of how the chemistry is going to work in this situation. And when any analyses are based on the dates and the normal procedures, just remember that there's a risk that neither of these sides has any historical precedent for knowing what they're doing in this particular confrontation. You could say they don't usually know what they're doing, so how much of a change is that; but, this will be a different type of not knowing what they're doing. It will be very hard to develop statistics for and it's something to keep in mind.

Polls that are relevant on this. When people are asked whether Clinton has made enough of an effort to try to talk to the Republicans and be forthcoming and so forth, people say yes by about 50% to 30% that he's done enough or has been acceptable. When the Republicans are asked the same thing about dealing with him, about 30% think that he has done enough, 45-50% think he hasn't been forthcoming enough.

There are already behind-the-scenes discussions in Washington about which funds the government can tap for how long, even though they're prohibited from doing any further borrowing and the government can shut down. But is it something that can have a number of unimagined consequences? Oh, yes. But it's just very difficult to know what the consequences will be.

I think Clinton is in the better position for two reasons. The first is because the numbers suggest people think he has made more of a concession, and he's good at seeming conciliatory. Newt Gingrich is not; that's not one of his things. The other reason why I think the odds are a bit on Clinton's side is because when people are asked for their opinion on Medicare versus budget cuts, large majorities prefer to have Medicare kept the way it is and have the budget cuts deprioritized. It looks like that is the centerpiece of the issue. Clinton has the more appealing position to the public, if you really draw lines between the two positions. So I would anticipate a mess in November of 1995. There are people who think that it's very likely that it would drag out until December and that Congress is not even equipped to deal with this very seriously by November 13. So the chronology laid out will probably slip.

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Let me go specifically to Medicare because I think it's important to underscore the extent to which the public hasn't really bought off on this. One of the things that was said, when the Republicans came back from being in the boondocks in August, was that they had won the battle. Some of you probably saw those stories that said that because they had convinced the people that Medicare was in a crisis. Well, according to the polls, they have not been convinced that Medicare was in a crisis. Only 20-25% think that Medicare is in crisis. Something like 45% think it's a major problem and 20-30% think it's a minor problem. Not even one-third agree it is in a crisis.

Then, if you ask what the public thinks of the Republican argument on Medicare versus the Democratic argument, not only do we have this division that I mentioned on crisis, but in the Gallop Poll, 51% oppose the GOP Medicare Plan and only 32% favor it. Sixty-four percent say the GOP is pushing changes too fast, while only 28% say Republicans are "moving with appropriate speed in providing enough time to consider the consequences." In an ABC/*Washington Post* survey, at the end of September 1995, 58% said it was more important to leave Medicare services as they are now rather than to reduce the deficit. Just 38% opted for the deficit reduction alternative. My feeling is that Clinton holds a stronger handle on this than people realize, partly because Clinton has played so weakly in the last six months that you don't really have the sense of Clinton being out there and playing hardball. But, if he's a good retail politician, and he seems to be, he may play hardball on this.

Let me turn from the Medicare issue to the larger question of health reform. I think that after this Congress is over, and the Medicare issue has been resolved in a way that probably won't be satisfactory to the American people or save enough money in the longer haul, you're going to see the next Congress have to deal very seriously with larger problems of health reform again. I don't see that either side can win on this politically; it's a question of which side can make the other lose politically. In the G-7 countries, specifically Canada, Germany, and the U.K., or virtually any country that has had a welfare state and tried to cut back on the public's Medicare equivalents and national health programs and put user fees on them, health reform has been a loser for the first couple of political stages. It was very tough for the Canadian conservatives in 1993, and it's been very hard for the British conservatives, and so on and so forth. I just don't see it as a winner here. I think it's going to be done in very unfavorable political and economic circumstances.

Now to the question of taxes. The whole climate presently is deemed to be different on tax issues because we're having a serious discussion, really for the first time, on various alternatives like a flat tax and a national sales tax. Well, they're not going to happen in this Congress. We all know that. The question is, is the debate that's coming in 1996 going to be as conducive to this as people think? I suspect not. I'll deal with that and some of the other questions that are coming up when I get to 1996.

In the short haul, the most interesting question is, whether in November and December that the Republicans can get away with such large proposed tax cuts for their various constituencies. If they don't get \$245 billion to make the constituencies happy, they need about \$185-205 billion and no lower. If you start to go lower, there's going to be a great deal of screaming. The Democrats leverage is to be able to keep the Medicare cuts to something like \$140 or \$160 million and deny the Republicans the money they

need for their tax cuts, so that their tax cuts would be inadequate to keep their coalition happy.

That's my Machiavellian view of, basically, what it's all about here. George Bush has the notion that there are all sorts of politicians in Washington sitting around reading Spinozza, Hagel, and so forth. Unless somebody named Spinozza signed a check for \$5,000 to the Republic National Committee, politicians are not reading them. Many things go on in Washington, but most of it has more to do with interest groupism and what you can do to get your money and how it's compatible with your framework, than philosophy.

Let me wind up on the idea of a national pension policy. When you get two parties that have to, for political reasons, rule Social Security off the table, and then they come mingling it back in through trying to play games with the CPI and the relative taxation of the portion of Social Security that's taxable above a certain level, you do not have a country in which there is a national pension policy. The Republican proposal basically allows the corporations to cash in their pension funds. Most people on Wall Street, who have any sense of where we are in the bull and bear market, have this gnawing feeling that as the market keeps going up, the size of the correction needed when it finally goes down, could be fairly substantial. The whole policy of the Republicans, in terms of giving corporations more access to their pension funds, is likely to be a real problem. There's no way that you can give statistics ahead of time to the probability of a bear or a bull market during the period in which this legislation would come into effect. But, obviously, if you could, I think it would be highly relevant.

Having said that, let me turn to the question of the business in the economic sense and in the sense of probusiness or antibusiness. In March 1996, this recovery will be entering its sixth year. You do have recoveries that last six years; we had one during the Vietnam War. You could argue we had one during the 1980s, but you wouldn't make the argument with much conviction if you were in Texas, Iowa, Idaho, or the commodity states because 1986 was a disaster and it had one down quarter during the year anyway, and another wasn't very positive. We came awfully close to having a recession in 1986. The moral of this story is that we're already at a very dangerous point in terms of longevity of the business cycle. And, if there is an argument to be made that the economy didn't pick up for the first two years of that business cycle, so it should be dated differently, but I think that's playing too cute a game.

The division that I mentioned between a Republican Congress and a Democratic president is something you can go back and look at historically. This is the third one that has occurred in the 20th century. The first was 1919-20, right after World War I; the second was in 1947-48, after World War II; and, ironically, the one after the end of the Cold War is not quite as precise. There are similarities, but basically, Democratic presidents have lost control of a messy political situation in the mid-terms; they haven't been able to get along well with the Republican Congress; and there have been shorter-than-usual business cycles.

In the cycle right after World War I, you had a recession beginning in either the first or second quarter of 1920. In 1948, you had a business downturn beginning in the fourth quarter that year. So what you can say based on the evidence is that business cycles

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tend to be truncated by this particular party pattern and split between Congress and the presidency, which would be a very important reason to watch 1996.

The Democrats, historically, also pin up a recessional pattern that's more likely to hit presidential elections than is the Republican pattern. I got my start in Republican politics, and one of the things that always struck me was that Republicans invariably managed to have recessions in time for the mid-term elections when they won the presidential elections. Now that you won the election, how can you give it away within two years? Have a recession in time for the Congressional election, such as in 1954, 1958, 1970, 1974, and 1982; there were virtual recessions in 1986 and in 1990, so the trend has been relentless.

Democrats have more of a record of having downturns come late in their presidencies, such as in the election years like 1920 and 1948. In 1980, there was the Carter credit crunch recession in the early part of that year. There is not enough evidence to say that it's a true pattern, but I would watch and do risk factoring for a recession in the presidential election year where the Democrat president is at loggerheads with a Republican Congress.

In terms of the other aspect here, there is the probusiness cycle. Now if you go back and look at American political history, it's fairly easy to define the periods where you had a lengthy probusiness attitude in national politics and periods where you had a reformist or antibusiness or regulatory business period. The so-called Populist Progressive Era from the 1890s through the 1920s (World War I began in 1914) was a regulatory period. The 1920s was a probusiness period. Then the New Deal was a regulatory, antibusiness period. Then the 1950s was a probusiness period that continued into the mid-1960s. Then you had a regulatory period from the Great Society through the Carter years. Then, in 1977-78, when the Democrats fell apart on consumer protection, when they lost control of tax reform, and when Carter came in there and had to appoint Paul Volker as an inflation beater, you essentially had the beginnings of a probusiness period, which is still going on. If you go back and look at the length of these periods and you correlate them with merger waves, business, public opinion, and relative profits in corporations, you will see many indicators that suggest that we're pretty close to the end of this probusiness cycle.

There is a highly relevant group of independent presidential candidates developing who are becoming very critical of lobbies, in some cases in finance and business. Ironically, besides Jesse Jackson, two of the most critical would be Ross Perot and Pat Buchanan; both are conservatives, in the sense of being right of center, and both have a populous streak. And by using all of these yardsticks, I would say that if the Republicans do not manage this Congress well, and at this point it's very debatable whether they will, part of the backlash that they could anticipate is this desire for an independent politics. It would begin to raise more questions for the whole present mix of probusiness government and tax changes that would move in a very probusiness direction; it would be very pro-upper-bracket. All of these things do have a history of changing when people don't really expect them to. I'd be alert for that in the course of the next two years. Many of the present paradigms of where this is all going could be wrong.

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To close, let's look at the politics of 1995–96. I'll do my own risk analysis of a party system in trouble, and I'll do it fairly quickly. You've all seen the polls; 60–62% of Americans are now in favor of a third party. And not only do they favor a third party, but the most recent *Washington Post*/ABC News Poll also showed that about 80% of those who favored it, which would make that close to 50%, thought that it was worth voting for them, even if a third-party president wouldn't be effective because it was a way of telling the other two parties what they were worth. I've never seen anything like that before. It used to be that third-party candidates could get up higher, but then they would retreat in the last two or three weeks of the campaign as people faced the reality of a two-party system. We are not psychologically still in that. Now you can look around the world and see that some of the other G-7 countries are beginning to move out of that too. In Italy and Japan, the old party system has pretty much collapsed. In Canada, in the 1993 election, the Conservative government wound up in fifth place; they went from 155 Members of Parliament to 2. They were passed in terms of representing English-speaking conservatism by the Reform party in Alberta, Canada; the Paratistas, their equivalent. In Britain, the Conservative party is in bad shape. There is a pattern of the old business conservative parties being weaker than people are discussing and of a rise in populous parties and movements. That usually doesn't last too long, but it can shake up the party system a great deal while it's underway.

We also have enormous anti-Washington numbers. The polls taken in the summer show that the public's disbelief in Washington had actually gone up from 1994. They did drop for a while in November, December, January, and February, but they are back up at least to where they were. And the extent to which you can have it back up to where it was without having people have the sense of whether you have an almost bilateral failure on the part of the parties I think is a real key to what's happening here.

I mentioned that George Bush got up to 90% in 1991 and dropped to 30% by August 1992. No president has ever dropped that fast. Clinton came in and within the first 100 days, he dropped more quickly in the polls than any president. Then Newt Gingrich came in and he too has a similar problem. People are, basically, not giving politicians much time; they don't believe in them anymore. They think that the system and the capitol city is not responsive and is wholly corrupted, but there are certainly interest groups to beat the band. And I think that this is part of the package that's creating the independent surge and also the set of issues that are potentially troublesome.

Now having said that, Bill Clinton is probably the individual most likely to be the president again in January 1997. Incumbent presidents are usually a good bet because even if there is only a 30–40% chance of getting back in, that's more of a chance than any other individual has, and I think that is the case. He profits enormously from no longer having the negative spotlight in American politics all to himself.

Back in 1994, who was the guy in Washington that was messing everything up? It was Bill Clinton. There wasn't anybody else there. You get all these reports from state troopers and you got to look at the diagrams of health reform that looked like a Rube Goldberg machine. Remember some of those great cartoons on the editorial page of *The Wall Street Journal*? I don't normally think too much of its editorials, but they had one diagram of the Clinton Health Program that was unbelievable; it looked like an

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organizational chart for a bankrupt Fortune 500 subsidiary. Clinton really laid an egg in that spotlight. The Republicans came in and now they're sharing the spotlight, and so is Bob Dole. Bob Dole's ratings have gone down steadily. He now loses to Clinton in two-way races by eight to ten points. He was beating Clinton by eight to ten points back in January, February, and March. So Clinton may not have a Democratic primary challenge. If he doesn't, he will be the first elected Democrat running for re-election since Franklin D. Roosevelt in 1936 not to have serious primary opposition. So you wonder how this fellow can get back in? It's not hard to imagine at all. If he doesn't have primary opposition within the Democratic party, he avoids the first pitfall. In 1968, Johnson had to retire after the primaries. Truman in 1952 had to retire. And, of course, in 1980, Carter was cut up so Reagan could beat him. If Clinton doesn't have those problems, he'll have a good start.

The second thing is that most of the independent candidates being talked about are people who come out of Republican politics, like Ross Perot, Colin Powell, Richard Lugar, and Pat Buchanan. Bill Bradley takes about evenly from each party and Jesse Jackson, of course, would take more from the Democrats.

Let's look at the Republicans. The Republicans face a real problem. Clinton probably won't have primaries. That could change, but at least it looks like that right now. What the Republicans need, in order to be strong in the general election, is to have a front-runner who isn't seriously in trouble; someone who puts it away in the first four or six weeks and doesn't get pulled down. They have had a front-runner who weakens and just barely wins and people don't think he should have been nominated. Or they have a front-runner who never really gets the majority of support but gets nominated anyway. The two examples of this behavior pattern since World War II occurred in 1948 with Tom Dewey and in 1964 with Barry Goldwater.

The great danger that the Republicans face is if Bob Dole falls apart and if Colin Powell doesn't make it. I can conceive of those two things happening together because I don't think that the Republican party is moderate enough to nominate Powell and Bob Dole has been losing ground. He's been running for president since 1976. When he was the vice presidential candidate with Ford, he never made it through the New Hampshire primaries. He is not a strong man, at this point in time, in terms of electoral appeal. When you have these sets of circumstances, you look at the independent candidates. I think there will be an independent candidate, and there might even be two, but whether there will be a strong one or not is the big question. Colin Powell, if he was to run as an independent right now, would win most of those races. When he runs as an Independent, the Republicans come in third.

I don't know what the odds are. If I were trying to predict the likelihood of Colin Powell being the presidential nominee on the independent ticket, I would say he has a one out of five or one out of six chance. If he were, the impact on the Congressional elections could be enormous. If you have the Republicans running in a close race to come in second in a three-way race for President, don't assume that they can hold what they've got in the Congressional races. On the other hand, if there's a strong Republican position in the presidential race, or, if people are worried about a need to watch Bill Clinton if he gets back in, then you will have some pressure on the Republicans.

I'll close by saying that I think Newt Gingrich and President Clinton, in a way, are each other's best friends because neither one can hold up the sort of yardstick of achievement in morality and integrity that America needs, which means they give each other a kind of immunity. You really have a great deal of skepticism in Washington that Gingrich wants Bob Dole to win. He wants Clinton in there because he would have to get out in the year 2000. Then Gingrich would be ready to run, and nothing interests him more than the idea of being the first President to go to space in the millennium or something else extraordinary.

MR. DANIEL J. MCCARTHY: An observation and a question. The observation is, your comments about the business cycle will certainly cause me and perhaps others to think about the fund allocations in our 401(k) accounts. We'll store that up and think about it. But what I really want to ask you about regarding all the polls is, do you really believe that national mood swings occur as rapidly as the polls indicate? And, if so, is there anything that you can point to that sort of explains this hypervolatility in contrast to past times?

MR. PHILLIPS: Well, I think the answer is, that on a certain level of public comprehension and indignation, I think they do occur quickly. I think they do that because the last 30 years of American politics and government have been enormously disillusioning to Americans. It began with LBJ and the assassinations, Vietnam and Nixon in Watergate, and OPEC and Carter's various problems. Reagan, I think, did marshal some belief for a while, but then, Bush did not, Clinton does not, and I don't think Gingrich does. I think that people just come to the conclusion more and more quickly now that they can't believe too much of this. On a certain level this is very powerful. They swing away and look for something new.

The other thing that is different that hasn't been there before, is that since the early 1970s, but especially since the stock market bubble in 1987 and then the recession in 1990, you've seen the polls that show that Americans think that their children will no longer be assured of the same living standard and that the economy can't be trusted in the future. They're worried about all kinds of things that relate to that. I think that adds up to the quickening of their response in those polls that the people in Washington are doing exactly what their predecessors did before. People just don't believe anymore and they have this sense—and I think quite legitimately, of Washington being a city where the insiders and political class do very well. It happens even though the rest of the country might not be doing too well.

MR. GREGG P. RICHTER: Could you speak to the effect of the baby boom generation on politics?

MR. PHILLIPS: I think this is an enormous problem. The baby boom started in 1945 or 1946. You are going to have these people become entitled to enormous entitlement burdens or their own pension system and there will be a sympathy with the politics of aging right about the time the U.S. has its largest exposure to failures or problems or shortages in the financial structure of entitlement for the aging. How are politicians going to mobilize without extremely effective blueprints for national sacrifice? The reason I emphasize all this is I don't think that the stuff that's being done in any way speaks to meaningful national sacrifice. The blueprints for going in and taking a huge chunk of money out of Medicare or cutting the capital gains tax, while presenting many

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corporate tax breaks is not going to mobilize people in the bottom two-thirds of the American population. In fact, they're not being mobilized.

I think there's an enormous problem that's facing us at some point in the first decade of the next century when many of these chickens come home to roost. But you cannot move ahead of time, unless you can (1) create a sense of a crisis; and (2) create a sense of a shared national remedy for the crisis, and we have not accomplished either of these. So I think the aging of the baby boom and its corollaries in terms of confidence in government and fiscal demands is a triple whammy; it's sort of equivalent to the triple witching hour.

MR. RICHARD S. ROBERTSON: You talked briefly about tax policy, but focused mainly on the near term. What about the longer term of flat tax, consumption tax, or a need for savings incentives? Do you see any of these going any place within the next several years?

MR. PHILLIPS: The one thing that I always favored as a remedy back in the 1980s—and I'm sorry that the 1986 tax reform wasn't more comprehensive—was a so-called business transfer tax (BTT), a value-added tax (VAT) minus the retail level. It struck me that if we had put that into effect at the same time the rates came down, you could have had a non-deficit neutral tax reform in 1986, which I think was a total mistake, but a very deficit favorable one that would have avoided some of the problems coming in here.

I oppose a national sales tax because you can't do that very easily with state sales taxes. I don't think we should use a big VAT as a way to bring the income tax way down; I think that's unfair. But I would favor some kind of BTT or a very limited VAT as an add on to keep the rate structure from having to move up too much. I think the whole notion of going to a flat tax has many weaknesses in terms of the failures in the structure. We would need about a 23% flat tax rate to raise the necessary money if you have the sort of federal government that would exist after the Republican budget cuts. You'd have to have even more for the federal government that exists now. That's not workable. If you had to put that number out there, the middle class would go bananas. So basically, I think people are looking too much at the notion of a great upper bracket simplification. The likelihood is probably going to be that there will be some kind of consumption tax that's either small or that is a partial substitute for the Federal Insurance Contributions Act (FICA) tax, or as an add on. That will keep things from ratcheting up more, but most of what I hear I don't credit.

