

The Bush Economy
A Speech to the American Enterprise Institute

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.... Our conservative movement is grateful for the intellectual leadership of the American Enterprise Institute. Under the stewardship of Chris DeMuth, AEI has become renowned for its scholarship, the care and precision of its work, and its influence and commitment to important ideas. No think tank in this city can match what AEI does, and it is an honor to be in the company of so many individuals who embody excellence.

This morning I will focus my talk on the economy during the Bush presidency. You may recall that when Governor Bush was President-elect Bush in December, 2000, he met with business leaders in Austin. They told him, in effect, “Congratulations. You ran a fine campaign. And oh-by-the-way, you will be inheriting a hurting economy.”

Their prognosis was grim – but they were right. Orders were drying up. Investment was falling. Consumer confidence and purchases were dropping off sharply. And markets were tanking.

The stock market began its decline in mid-January 2000, dropping from an all-time high of more than 11,700 to below 9,800 in early March 2000 on its way to its first calendar-year loss since 1994.

The dot-com bubble also burst in 2000. The NASDAQ, site of some of history’s biggest IPOs, peaked on March 10, 2000 – and by December 2000, it had dropped by more than 50 percent.

The economy itself began slowing in the third quarter of 2000, as GDP declined by an annual rate of one-half percent. All this took place before George W. Bush set foot in the Oval Office.

The economy posted another decline in GDP growth in the first quarter of 2001 (-0.5 percent) and March 2001 marked the recession’s official start. Sluggish growth of 1.2 percent followed in the second quarter of 2001, and GDP growth declined again in the third quarter, falling 1.4 percent.

As in past recessions, no single factor caused the 2001 recession; it resulted from declining stock markets, a surge in energy prices, higher interest rates, and the collapse of high-technology industries.

Then, on a bright September morning, came the worst attack on the American homeland in our history. Al Qaeda targeted our political and financial centers and intended to bring our economy to its knees. That didn’t happen, but serious damage was done.

Airports were shut, stock markets closed, the hospitality and insurance industries were hit hard. The country suffered an estimated \$100 billion in economic losses. And in the three months following 9/11, almost a million jobs were lost.

That fall, a series of corporate fraud cases began coming to light. Among other things, these scandals led to the largest bankruptcy in U.S. history. Confidence in the market was understandably shaken – and the Dow Jones dropped to below 7,300, a five-year low. At the time the *Financial Times* said: “Forecasts of a Dow diving to 5,000, 3,000 and even below 1,000 have been receiving attention from investors who once could not believe the Dow would fall below 8,000.”

A faltering economy, falling markets, shaken confidence, an economy reeling. That is what America’s new President faced. In times like these, the principles and values of a President come into play.

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This President believes government’s role is to create an environment where the entrepreneurial spirit flourishes and where small businesses can grow, where people can dream about owning their own home and have it become a reality. And he believes economic growth is created largely on the economy’s supply side; the best tax cuts create incentive for people to work and businesses to produce and companies to invest.

President Bush doesn’t believe government creates wealth; he understands that is done by American workers, farmers, and entrepreneurs.

President Bush’s economic policies, then, are tied to a view of human beings that understands the role of incentives in shaping behavior. There are three important elements of those policies: the tax system, trade liberalization, and budget discipline.

The President believes when the economy falters, tax cuts will lead to economic prosperity. This reflects a deep faith in individual citizens, in their energy and common sense and capacity to make wise decisions. His view of free trade is grounded in the knowledge that American producers and workers can compete and win internationally as long as the rules are fair. And an emphasis on a responsible federal budget reflects the President’s belief that while government should actively perform its core functions, it should not impede the efforts of individual citizens and enterprises to create jobs, wealth, and economic opportunity.

Let me briefly deal with each of these topics: taxes, trade, and spending.

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In response to the economic challenges the country faced, President Bush provided Americans with the largest tax relief in a generation. With the help of the Republican Congress, he has secured passage of five major tax relief bills.

He has led a successful effort to cut taxes every year he's been in office. We have seen taxes cut on income, small businesses, dividends, and capital gains. The child credit has doubled, the marriage penalty has been reduced, and the death tax has been put on the road to extinction. Taken together, these tax cuts have strengthened the economy, increased productivity, and created new jobs.

Just last week, in a major legislative achievement, Congress passed an extension of the capital gains and dividend tax cuts until the end of 2010; a bill signing ceremony will take place on Wednesday.

An important point about the impact of the capital gains and dividend tax cuts: between May 28, 2003 when the President signed the legislation into law and December 31, 2005, the 500 leading U.S. companies on Standard & Poor's 500 index have increased their dividend payments 725 times and quarterly dividend payments averaged almost \$47 billion per quarter – a 51 percent increase compared to the quarterly average during the 10 years prior to the 2003 tax cut.

President Bush's tax-cutting policies were not passed by unanimous consent. Some in Congress oppose any significant tax cuts. Indeed, some members of Congress predicted economic ruin if the President's tax relief was passed.

One called it "akin to arsenic poisoning for the economy;" another said it was "nothing more than a sham, wrapped in spin, shrouded with deception" and would bestow "no real benefits on most American families."

These aren't arguments; they are the political equivalent of school yard jeers. But more substantive points were raised in opposition. One criticism was that "The vast majority of its benefits were directed toward the wealthiest."

If this were true, then the percentage of federal income taxes paid by the wealthy would be falling after the tax cuts. That is not the case. The Bush tax cuts have shifted more of the burden onto the wealthy. Those lower on the economic ladder were relieved of a larger share of their tax burden.

The top one percent's (over \$317,000) share of income tax payments is up by nearly one-and-a-half percentage points. For the top three percent (incomes above \$200,000), their share of the tax burden is up more than five percentage points – from 40.5 percent to 46.6 percent. And the tax burden of the top five percent (incomes over \$141,000) is up almost three percentage points. According to the *Wall Street Journal*, for every 100 Americans today, the wealthiest three are now paying close to the same amount in taxes as the other 97 combined.

Other critics claim "The tax cuts have played a major role in the return to deficits and burgeoning debt."

The problem with this critique is that it ignores that tax revenues are at an all-time high – in large measure because of the economic growth tax cuts created. Last fiscal year, for example, revenues confounded the experts by surging by \$274 billion – almost 15 percent. And it is happening again. The Treasury Department's

most recent report shows tax receipts were up by \$137 billion – or more than 11 percent – for the first seven months of fiscal year 2006.

Corporate income tax receipts are up nearly 30 percent, while individual income tax receipts have increased by 10 percent in what has been dubbed a “revenue tsunami.” If revenues for 2006 grow by 11 percent, federal taxes will be equal to 18.4 percent of the economy – higher than the 40 year historical average. In the words of the *Journal*, this is “the largest two-year increase in tax revenue collections – after adjusting for inflation – ever recorded.”

This surge in revenues means that we are on track to achieve the President’s goal of cutting the deficit in half by 2009. It’s worth noting that just the other week, the CBO lowered its deficit forecast for this year, predicting that the large increase in tax revenues would cut the deficit to around 2.5 percent of GDP.

Another criticism of the tax cuts came from a former high-ranking Democrat official who dismissed the tax cuts by saying "We had very good markets in the '90s before all these tax cuts went into effect." I’m not all that certain most Americans would applaud returning to the end of 2000 when (a) the Dow had just experienced its first calendar year decline since 1994 and (b) the NASDAQ had dropped by 50 percent.

It’s not just that the critics predicted nearly the opposite of what happened. The President’s critics were not only wrong; they could not have been more wrong.

Take the frequent claim that the President “failed to put forth a responsible economic plan to create jobs.”

That’s simply false. The American economy created more jobs than all the countries in the Euro zone and Japan combined, and our economy is growing faster than the economy of any other major industrialized nation.

It grew at an annual rate of 4.8 percent in the first quarter and added more than 5.2 million jobs in the last two-and-a-half years. Employment is near an all-time high. Claims for unemployment insurance are at a five-year low. The unemployment rate is 4.7 percent, well below the average for each of the past 3 decades.

Core inflation remains low, rising just 2.1 percent over the past 12 months. Mortgage rates remain near historic lows and homeownership remains near a record high, with sales of new and existing homes reaching record levels in 2005.

Real disposable personal income has risen almost 14 percent since President Bush took office. The Dow Jones Industrial Average is near its all-time high, and since the 2003 tax cuts passed, asset values (including homes and stocks) have grown by \$13 trillion.

The reality is that tax cuts have helped make the American economy the strongest in the world.

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A second component of the President's economic policy is free trade. President Bush believes trade is an important source of good jobs for our workers, higher growth for our economy, and bigger earnings for our farmers and for our factories. For example, exports accounted for roughly one-quarter of all U.S. economic growth in the 1990s – and jobs in exporting plants pay wages that are up to 18 percent higher than jobs in non-exporting plants. Free trade has a proven record of creating new opportunities for our entrepreneurs; expanding choices for America's consumers; and raising living standards for our families.

America is once again in the business of promoting open trade to build our prosperity and to spur economic growth.

Under the President's free trade agenda, the U.S. has completed 14 bilateral trade agreements since 2001. How important is it to expand the scope of economic freedom through free trade agreements? Our free trade partners represent 14 percent of world GDP (excluding the United States from the world total) but 52 percent of total U.S. goods exports in 2005. Clearly, it is in our economic interest to tear down walls to the sale of American goods and services.

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The third component of the President's economic policy is restraint of federal spending. The President has reduced the growth of non-security discretionary spending every year in office. In the final year of the previous administration, non-security discretionary spending grew by 15 percent. President Bush worked with Congress to cut that figure, reducing non-security discretionary spending growth to six percent in FY02, five percent in FY03, four percent in FY04 and three percent in FY 05.

For FY06, the President worked with Congress to actually cut non-security discretionary spending from the previous year's level – the first time since the Reagan administration – and hold growth in total discretionary spending below the rate of inflation.

The President's FY07 budget again proposes that non-security discretionary spending growth receive an actual cut and that growth in discretionary spending again be held below inflation.

How was this done? Take last year; the Administration issued 39 veto threats on six appropriations bills – and Congress responded to those veto threats by restraining spending to the levels in the President's budget.

To put it mildly, this has been an underreported achievement.

Here is another fiscal fact people may be unfamiliar with: Under this President, federal spending as a percentage of the economy is lower than under four of the last five presidents and the high-water mark for the budget deficit as a percentage

of the GDP for this Administration (3.6 percent) is significantly less than was the case in the 1980s (as high as 6 percent).

The President's tax cuts, trade liberalization and spending restraint helped strengthen the economy's foundation and added fuel to our economic recovery. Not a bad record.

The American economy still faces challenges. The first of 78 million Baby Boomers are beginning to retire and by 2030, spending for Social Security, Medicare and Medicaid will comprise almost 60 percent of the federal budget. This is a serious threat to our fiscal well-being.

And while the topic of entitlements is beyond the scope of my prepared remarks this morning, I will point out no President has made a more concerted or determined effort to reform Social Security, our nation's largest entitlement. The President encountered enormous resistance to what was a bold but practical reform. There will be a price to pay for the political intransigence to his reform agenda. And President Bush will continue to keep entitlement reform front and center on the political agenda.

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I suspect the temptation for some policymakers is to forget that beyond the economic statistics lie compelling human stories. That is a temptation we must resist. We must remember economic growth creates work, which is a source of human dignity.

In his 1981 encyclical, "On Human Work," Pope John Paul II wrote, "human work is a key, probably the essential key, to the whole social question ... work is a fundamental dimension of man's existence on earth ... Work is a good thing for man – a good thing for his humanity because through work ... he ... achieves fulfillment as a human being."

This is an important reminder that prosperity is not just an end in itself. Prosperity is also a means to broader ends and greater purposes.

Things don't happen in Washington by accident. They happen because of the right policy and the right leadership. AEI has done much to foster both. And who knows, maybe there is a young college student out there today reading an AEI study on telecom deregulation who will be inspired by the world of conservative ideas. I was fortunate to have been in that position myself a long time ago.

I am honored to have been invited today. Thank you for your attention.