

Message to Congressional Leaders Transmitting the 1991 Economic Report

February 12, 1991

To the Speaker of the House of Representatives and the President of the Senate:

Just over 8 years ago the longest peacetime economic expansion in U.S. history began. By the start of the 1990s the unemployment rate had fallen to levels not seen since the early 1970s, and inflation remained relatively low and remarkably stable when compared with the 1970s. More than 20 million new jobs were created by our dynamic and diverse market economy—the largest and the most productive in the world. Reflecting both the evolving needs and wants of the American people and the rapid advance of technology, some industries and regions experienced much more robust job growth than others. And, as is normal during economic expansions, the rate of growth of the Nation's output varied from year to year.

The events of 1990 were a reminder that even a healthy economy can suffer shocks and short-term setbacks. In early August, Iraq invaded and occupied its small, defenseless neighbor Kuwait and threatened Saudi Arabia. Oil prices rose substantially on the world market, and business and consumer confidence plummeted. These shocks hit an economy that was already growing slowly for several reasons, including worldwide increases in interest rates, tightened credit conditions, and the lingering effects of a successful attempt begun in 1988 by the Federal Reserve to prevent an acceleration of inflation. U.S. output turned down in the fourth quarter of 1990, and it became clear that the economy had entered a recession. I know that in some regions of our country, people are in genuine economic distress.

This temporary interruption in America's economic growth does not signal a decline in the basic long-term vitality of the U.S. economy. Indeed, there were important economic achievements in 1990. Even though many analysts had earlier forecast increased inflation, the underlying rate of

inflation was contained and showed clear signs of declining by the end of the year. Low inflation is essential to lower interest rates and strong economic growth. The U.S. trade deficit declined for the third year in a row, and U.S. firms remained competitive in world markets. Exports of American products reached an all-time high in 1990 and exceeded those of any other nation. Productivity in U.S. manufacturing continued to grow impressively. Some regions and industries experienced relatively strong job growth.

My Administration's economic policies are designed both to mitigate the current downturn and to provide for a solid recovery and the highest possible rate of sustainable economic growth. Because these policies are credible and systematic, they reduce uncertainty and pave the way to higher growth with sustained job-creating expansions. With these policies in place, the current recession is expected to be mild and brief by historical standards.

Economic growth is projected to recover by the middle of this year. Inflation and interest rates are expected to decline. With the adoption of my pro-growth initiatives, the recovery and ensuing expansion are projected to be strong and sustained, and to be accompanied by continued progress toward lower inflation.

As the Nation proceeds into the 1990s, it is important to remember the simple secret of America's economic success in the 1980s: a government policy that allowed the private sector to serve as the engine of economic growth. We must also remember that economic growth is the fundamental determinant of the long-run success of any nation, the basic source of rising living standards, and the key to meeting the needs and desires of the American people.

The process of growth necessarily involves change. Advances in technology, shifts in world market conditions, and changes in tastes and demographics have created major new industries and dramati-

cally altered the fortunes of existing industries. The lesson of history is clear. Attempts to protect special interests by blocking the economy's natural, market-driven evolution—through regulation, subsidy, or protection from competition—reduce the economy's flexibility and impair its ability to grow and to create jobs. Growth and prosperity are enhanced by strengthening and extending the scope of market forces, not by substituting government dictates for the free choices of workers, consumers, and businesses.

Toward Renewed Growth

The budget law enacted last fall gives fiscal policy a strong and credible medium-term framework. It increases the ability of the fiscal system to dampen the impact of the current recession, while providing for strong controls to reduce Federal spending as a percentage of our gross national product. A major reason that the budget deficit is expected to increase this year—before declining steadily thereafter—is the increase in payments to those adversely affected by the current downturn and the reduction in tax receipts as incomes grow more slowly. These automatic responses to the recession will help cushion its effects.

I am committed to maintaining a tax system that will sustain strong economic growth. My proposal to reduce the tax rate on capital gains would give a needed boost to the economy and set it on a strong course of economic growth and job creation for years to come. A lower capital gains tax rate would encourage entrepreneurial activity, which plays a critical role in creating new jobs, new products, and new methods of production. It would reduce the bias in favor of debt financing and thereby decrease the financial risks borne by U.S. corporations and their workers and shareholders.

The Federal Reserve's control of inflation throughout the recent long expansion has given it the credibility necessary to mitigate the current downturn significantly without triggering an increase in inflationary expectations. Federal Reserve action in recent months will also help to alleviate tight credit market conditions that have hampered the economy. It is important that the Federal

Reserve sustain money and credit growth necessary for the maintenance of sustained economic growth, especially during an economic downturn. And, while unwarranted risks should be avoided, I believe that sound banks should be making more sound loans.

Comprehensive banking reform will help to alleviate tight credit conditions by reducing unnecessary restrictions on the banking sector. Healthier depository institutions are essential for a sound financial system. Lifting restrictions on interstate banking activities and on the ability of banks to combine with commercial and other financial firms will increase banks' competitiveness. These changes will enhance banks' ability to attract capital and reduce the risk of a contraction in lending.

Some have argued that the government should react to the recent oil price shock by reregulating energy markets. They would do well to remember the lessons of the 1970s, when regulation worsened the impacts of two oil shocks and forced Americans to waste many hours in long and unnecessary lines at gas stations. Long-term uncertainties about energy prices make it vital that U.S. energy policy be based, in both the short run and the long run, on the flexibility and efficiency that only well-functioning markets can provide.

My Administration's National Energy Strategy calls for removing unnecessary barriers to market forces so that ample supplies of reasonably priced energy can continue to foster economic growth. The Strategy also outlines initiatives to enhance the energy security of the United States and its friends and allies, to encourage cost-effective conservation and efficiency measures, to increase the use of alternative fuels, and to continue to mitigate the environmental consequences of energy use.

Supporting Long-Run Growth

The Federal Government cannot mandate or effectively direct economic growth, but it can and should create conditions that encourage market-driven growth. That requires reducing barriers to saving, investing, working, and innovating. Encouraging growth also requires sustaining and expand-

ing the role of market forces and, thereby, enhancing the economy's flexibility. Attempts to second-guess the market and to direct government support to particular firms, industries, or technologies in the name of promoting growth are inevitably counterproductive.

The multiyear Federal deficit reduction package adopted last year, the largest and most comprehensive such package in U.S. history, will reduce the Federal budget deficit by nearly a half-trillion dollars over the next 5 years relative to baseline projections. This substantial reduction in government borrowing will raise the national saving rate and increase the pool of funds available to finance job-creating private investment in new productive capacity and new technology.

My Administration remains firmly committed to taking additional steps to lower the cost of capital and to encourage entrepreneurship, saving, investment, and innovation. I have again asked the Congress to reduce the tax rate on long-term capital gains and to make the research and experimentation tax credit permanent. To encourage private saving, my budget again includes Family Savings Accounts and penalty-free withdrawals from Individual Retirement Accounts for first-time homebuyers. My Administration will seek increased Federal support for research that has broad national benefits, and we will make the results of government-supported research more accessible to the private sector so that they can be brought more quickly to market.

Strong economic growth will continue to require a sound national transportation infrastructure. My Administration's proposals for restructuring highway programs, centered around a new National Highway System program, would make a substantial contribution to meeting those demands.

Economic growth requires skilled and adaptable workers as well as modern capital and new technology. Excellence in education is the key to increasing the quality of the U.S. labor force. My Administration is strongly committed to making the U.S. educational system second to none, so that U.S. workers can continue to compete effectively with their peers in other nations. To meet this goal, the performance of U.S.

elementary and secondary education must be dramatically improved. More money will not ensure excellence; America is already a world leader in spending on education. Fundamental reform is necessary.

Government policies should be designed to put power in the hands of individuals and families—to give them the tools and incentives to improve their own lives. Thus students and their families must be given greater freedom to choose among competing schools, and talented and skilled individuals must be freed from unnecessary obstacles to entering the teaching profession. My Administration will seek enactment of a new Educational Excellence Act that would support choice in education, alternative certification for teachers and principals, rewards for outstanding teachers and for schools that improve their students' achievements, and innovative approaches to mathematics and science education.

The Immigration Act of 1990, the first major reform of legal immigration in a quarter-century, will substantially increase the overall level of immigration, particularly of skilled workers. These new workers will contribute to U.S. economic growth, as well as to the Nation's social and cultural vitality.

The Americans with Disabilities Act is the most significant extension of civil rights legislation in two decades. It will enable more of our citizens with disabilities to enter the economic mainstream and thus to better their own lives while contributing to the Nation's economic strength.

Last year important legislation passed that will give power and opportunity to individuals. The expansion of the Earned Income Tax Credit, the new health insurance credit, and the other child care provisions in the 1990s budget legislation will put dollars for child care directly in the hands of parents, instead of bureaucracies. The Homeownership and Opportunity for People Everywhere (HOPE) initiative in the National Affordable Housing Act will expand homeownership and give more families a stake in their communities. My Administration strongly supported the expansion of Medicaid to provide health insurance to more pregnant women and chil-

dren in low-income families.

But there is more to be done. My Administration will continue to press for the establishment of enterprise zones to encourage entrepreneurship, investment, and job creation in distressed communities. We will propose initiatives focused on infant mortality, preventive measures, and nutrition to improve the health of those least able to provide for their own needs.

Flexibility and Regulation

The remarkable flexibility of the U.S. economy, which stems from its reliance on free markets, is a major national asset. Flexibility enables the economy to cushion the effects of adverse developments, such as oil price shocks, and to take full advantage of innovations and other new opportunities. Indeed, the responsiveness of the economy to new opportunities is an important spur to innovation and a source of economic dynamism.

Government regulation generally serves to reduce economic flexibility and thus should have a very limited role. Where regulation is necessary, regulatory programs should pass strict cost-benefit tests and should seek to harness the power of market forces to serve the public interest, not to distort or diminish those forces.

The lesson of the savings and loan crisis, to which my Administration responded swiftly, is not that competition and innovation are incompatible with safety and soundness in the financial sector. Rather, this experience shows that poorly designed regulation, inadequate supervision, and limits on risk-reducing diversification can combine to produce behavior that undermines creditors' confidence and imposes unnecessary burdens on taxpayers.

We can and must ensure the safety and soundness of our banking system and continue to provide full protection for insured deposits while allowing competition to improve efficiency and encourage innovation. My Administration's proposals for comprehensive reform of the regulatory system governing banks will achieve these goals. In addition, these reforms will enhance the ability of U.S. banks to compete in the global markets for financial services.

Last year's farm legislation embodied im-

portant steps toward a market-oriented agricultural policy and away from government domination of this vital and progressive sector. Farmers have been given additional flexibility in planting decisions, in a way that will both sustain farmers' incomes and save taxpayers' money.

Market-based initiatives can and should play a key role in environmental policy as well. In 1989 my Administration proposed comprehensive legislation to combat air pollution. This proposal broke a logjam that had blocked congressional action for more than a decade, and a landmark clean air bill was enacted last year—the most significant air pollution legislation in the Nation's history. The centerpiece of this bill is an innovative, market-based program for controlling—at the least possible cost to the economy—the emissions that produce acid rain. All provisions of this legislation will be implemented so as to minimize unnecessary burdens on American workers and firms.

Economic growth and environmental protection are compatible, but only if environmental goals reflect careful cost-benefit analysis and if environmental regulation provides maximum flexibility to meet those goals at least cost. My Administration will continue to be guided by the responsibilities of global stewardship; we will seek both to protect the environment and to maintain economic growth to give all the world's children the chance to lead better lives than their parents.

Leadership in the Global Economy

Throughout the postwar period, the United States has led the world toward a system of free trade and open markets. The benefits of global economic integration and expanded international trade have been enormous, at home and abroad. U.S. firms gain from access to global markets; U.S. workers benefit from foreign investment in America; and U.S. consumers can buy goods and services from around the world. Competition and innovation have been stimulated, and businesses have increased their efficiency by locating operations around the globe. The phenomenal prosperity and vitality of market-oriented economies—and the bankruptcy of the socialist model—

point the way to future progress and growth.

My Administration will continue to push aggressively for open markets in all nations, including our own, and will continue to oppose protectionism. Protectionist trade barriers impose burdens on the many to serve the interests of the few and can only reduce the Nation's competitiveness. Government attempts to overrule the decisions of the international marketplace and to manage trade or investment flows inevitably reduce economic flexibility and lower living standards.

My Administration's top trade policy priority continues to be the successful completion of the Uruguay Round negotiations of the General Agreement on Tariffs and Trade (GATT). Success in the Uruguay Round would open agricultural markets, lower or eliminate tariffs on many products, strengthen the GATT system, and extend it to cover important new areas—such as services, investment, and intellectual property—critical to U.S. economic vitality. These improvements would significantly increase the ability of the global economy to raise living standards in the United States and around the world. Failure, on the other hand, would increase trade frictions and could lead to a destructive new round of protectionism.

In addition, my Administration has moved to pave the way toward a hemispheric zone of free trade. We have announced our intention to begin negotiations on a free-trade agreement with Mexico. My Enterprise for the Americas Initiative promises to fuel growth and prosperity throughout this hemisphere by removing barriers to trade and investment. This initiative also aims to provide official debt reduction to countries engaged in significant economic reforms and thereby to build on my Administration's ongoing support for commercial debt reduction.

America remains a beacon of hope to peoples around the world. Our Nation continues to demonstrate by shining example that political democracy and free markets reinforce each other and together lead to liberty and prosperity. Nations in this hemisphere and the emerging democracies of Eastern Europe are eagerly moving to follow America's example. The challenges these nations face as they fundamentally restructure their economies are enormous. My Administration will continue its strong support and assistance for their vital and historic efforts.

Looking Ahead

In my *Economic Report* last year I stated that I looked forward to the 1990s with hope and optimism. Despite the economic events of 1990, we have reason for both hope and optimism in full measure as the Nation approaches the next American century.

Following sound economic policy principles, my Administration seeks to achieve the maximum possible rate of sustainable economic growth. We must continue to adhere to those principles if we are to soften the impacts of the current recession and to strengthen the foundation for strong growth in the years to come. Economic growth remains the key to raising living standards for all Americans, to expanding job opportunities, and to maintaining America's global economic leadership.

GEORGE BUSH

The White House,
February 12, 1991.

Note: The President's message was printed in the "Economic Report of the President" but was not issued as a White House press release. Thomas S. Foley was Speaker of the House of Representatives, and Dan Quayle was President of the Senate.