CHAPTER ONE

We're Fixing a Hole

In November 1996 the American people voted to retain Democrat Bill Clinton as president and to keep Republicans as the majority party in Congress. These partisans were no strangers to each other. In 1995 they had fought an epic battle of the budget, waging a political war that shut the federal government not once, but twice. Partisanship reigned supreme as the two sides held the federal government and the American people hostage. When the dust finally settled, the only sure results were negative: bitterness, distrust, and, despite all the sound and fury, an enormous deficit hole that still needed fixing.

Now it was January 1997, and the American people had bestowed a fresh start on their elected leaders. At this critical juncture, America's leaders would either reignite the partisan wars or perhaps, just perhaps, overcome their wounds and launch a bipartisan effort to balance the budget. To succeed, they would have to reach out to each other and find a way to accommodate their competing political and policy objectives—while hopefully pointing all that partisan power toward the national interest.

Immediately after the 1996 election, President Clinton instructed the administration staff to prepare a balanced budget plan that could serve as a starting point for the bipartisan route, touting Democratic priorities but also leaving room for the necessary compromises with the Republican Congress. Given the hard feelings and mistrust that lingered palpably after the 1995 debacle, it would be a major accomplishment simply to forestall the partisan warfare that usually accompanies the president's budget submission to Congress. With that in mind, Erskine Bowles, the White House chief of staff, agreed that I should launch a secret foray into the Republican camp—not to weaken the opposition but to build a modicum of trust before the president presented his budget proposal to Congress. As head of the White House office of legislative affairs and a former congressional staffer, I would make the first contact.[1] These talks had to remain hidden, not just from rank-and-file Republicans but also from many Democrats, both in Congress and in the White House. Erskine and I knew our outreach to the other side would never get off the ground if we first ran our intentions past congressional Democrats bent on partisan warfare. The same was true for many of the White House staff with all their Capitol Hill connections.

Friday, January 24, 1997

There was a natural place to start—in the Senate with Pete Domenici, the Republican chairman of the Budget Committee. For institutional and cultural reasons, the Senate is more bipartisan than the House. The filibuster and other procedural roadblocks available only in the Senate grant a great deal of stopping power to the minority party. As a result, the legislative path in the Senate often runs down the middle, and senators are more accustomed than House members to working with the other side.

The son of a grocer and one of five children, Domenici was a self-made man. He had served ably as one of Republican leader Bob Dole's principal lieutenants but had been rebuffed for leadership posts.[2] He had suffered the disappointment of being passed over for the vice presidential nomination in 1988 in favor of Dan Quayle. But he had borne it all with good grace and fortitude, and he had mastered the feat of being a hard-nose budgeteer while generously helping his home state of New Mexico from his seats on the Appropriations and Energy Committees.

Domenici was an accomplished legislator and a tough negotiator who could work with the other side. He had been a central part of every budget negotiation since the early 1980s, and he had proven his willingness to take unpopular stands.[3] Equally important, based on years of experience, I knew that I could trust Domenici to be open to our overtures while keeping our talks confidential.

On budget matters, Domenici was inseparable from his extraordinarily capable Budget Committee staff director, Bill Hoagland. So it was the three of us who met in the quiet of Domenici's office in the Hart Building late on a Friday afternoon—thirteen days before the president's budget would become public. It quickly became apparent that Domenici's main concern was the role he would play in the Senate over the coming year. For nearly two decades he had been Senator Dole's confidant and strength. But Domenici was not certain where he stood with Trent Lott, the new and more conservative Republican leader from Mississippi who had succeeded Dole in mid-1996. Hoagland put Domenici's concerns bluntly: was the White House negotiating privately with Lott? Of course not, was my honest reply. We were not negotiating with anybody yet; Domenici and Hoagland were the first contacts the White House had made on the Republican side.

Domenici was also worried about the challenge facing the budget committees in both the Senate and House. They were charged with drafting the initial budget blueprint setting overall tax and spending levels for the federal government. Only when that resolution had been passed could the congressional appropriations committees begin to allocate spending to specific government programs.[4] An important part of the budget committees' effort was to compel the other congressional committees to legislate program changes to back up the numbers in the budget resolution. Domenici knew it would be a tough job in the Senate. His first instinct was to try to put together a bipartisan budget in committee in partnership with Senator Frank Lautenberg of New Jersey, the new ranking Democratic member. But he had no illusions about the prospects for success. The membership of the Senate Budget Committee was badly skewed. The Democrats were more liberal than the majority of their caucus, and the Republicans more conservative than their Senate brethren.[5] It was not a recipe for compromise.

Domenici wanted to know the prospects of working out something in advance with the White House. If an agreement could be reached, his committee would craft a bipartisan budget resolution reflecting the compromise. And if his committee would not cooperate, he had a backup plan. He would bypass the Budget Committee and take the agreement with the White House directly to the Senate floor.[6] It was a startling offer from a veteran chairman: he was willing to circumvent his own committee if that's what it took.

In response, I explained that the White House believed that a major deficit reduction package could achieve a balanced budget by 2002. Moreover, the White House believed that a balanced budget could be achieved through spending reductions alone, avoiding the need for tax increases and even leaving room for a tax cut as part of the bargain. But in the midst of all those spending reductions, there would have to be room for the president's initiatives in health care, education, the environment, welfare reform, crime and drug prevention, and science and technology. Domenici did not miss a beat. He said he understood the need to accommodate many of the president's priorities, but he would do so only if the budget agreement restrained the growth of entitlement spending in programs like Medicare and Social Security. He followed with a bold suggestion to adjust the consumer price index (CPI), the economic measure used to determine cost-of-living adjustments (COLAs) in government benefit programs. Economists generally agreed that the CPI overstated the true rate of inflation.[7] Domenici was asking the obvious question: why not make the CPI adjustment part of an agreement and take credit for it in the budget? The effect would be enormous. Lowering the CPI by half a percentage point would reduce COLA payments to beneficiaries—and thus reduce the budget deficit—by $25 billion in 2002 alone. But forcing an adjustment in the CPI would bring into play the third rail of American politics, Social Security. It would also send the labor unions into a frenzy since wage adjustments are negotiated in light of the measured rate of inflation.

Domenici knew the fallout that any proposal to reduce the CPI would create, so he was quickly, but very privately, putting the idea on the table. Republicans had been badly burned in the past by advocating COLA reductions. This time the party would venture forth only in partnership with a Democratic president.

Returning to the White House, I reported back to Erskine Bowles, who had recently succeeded Leon Panetta as White House chief of staff; Erskine had been deputy chief of staff in 1994 and 1995 in the first Clinton administration before returning to the private sector. He was a moderate who would work hard to see all sides and find the middle. Perhaps particularly important, he had not been a party to the divisive budget battles of 1995.

I had good news: Domenici wanted to engage. Erskine and I quickly decided to expand our quiet diplomacy on both sides of the aisle. On the Democratic side we would do our normal briefings on the president's budget proposal to leaders and committees before the State of the Union address on February 4 and the president's budget submission on February 6. Given our quiet initiatives with the Republicans, it was essential to show the flag of party unity by very publicly briefing key Democratic members and staff. On the Republican side, our goal would be to make enough contacts to ensure that the president's budget submission would "arrive alive." This would be no easy feat. In the 1980s and 1990s, members of the opposing party had adopted the vocabulary of forensic examiners to rate the survival chances of the president's submission. When the two sides were far apart, the president's budget would quickly be declared "dead on arrival," or, if the president were lucky, on life support, barely breathing, or on its last leg. Congressional Democrats had done it to Presidents Reagan and Bush, and during his first administration, the

Republicans had returned the favor to President Clinton. We were determined to avoid this fate.

THAT MEANT ANTICIPATING all sorts of wild cards. On the House side, perhaps the wildest was Budget Committee chairman John Kasich of Ohio. In 1995 he had played a key role in moving the Republican Contract with America budget bills through Congress and onto the president's desk, setting the stage for the veto showdowns that closed the federal government. The Contract with America, the cornerstone of the successful 1994 Republican campaign to gain control of the House, laid out a sweeping agenda whose lead items were balancing the budget and cutting taxes.

Kasich was a man of strong convictions who wanted to cut taxes, cut spending, and balance the budget under the deficit projections produced by the Congressional Budget Office (CBO), which were more austere than those generated by the White House Office of Management and Budget (OMB). He was a true believer in small government and fiscal responsibility. We would need to talk with Kasich before the president's budget saw the light of day.

WHAT ERSKINE AND I had not counted on, however, was our own wild card, President William Jefferson Clinton. He was doing his own outreach to Senate Republican leader Trent Lott. Domenici's suspicions were more accurate than our inside information.

Lott had succeeded Dole as Senate majority leader the previous spring after Dole decided to leave the Senate in order to devote all his efforts to his presidential campaign. Wanting to establish a record of legislative accomplishment, Lott had quickly proven his ability to work with the Clinton White House in passing welfare, health, and environmental legislation in the closing days of the 104th Congress.[8] Sensing electoral peril in the wake of the government shutdowns, the House Republican leadership had done its part to move those pieces of legislation, giving up on the kinds of controversial legislative riders and poison pills that voters might see as extreme.[9]

The president's desire to reach out to Lott was natural and recognized the new reality in the Republican leadership. The 1995 budget collapse and the loss of several House seats to Democrats in the 1996 elections had weakened House Speaker Newt Gingrich inside his caucus and in the public eye. The Speaker was also weakened by an ethics investigation into allegations that he had improperly mixed political and other funds.[10] In contrast, Senator Lott had risen in profile and power, particularly since the 1996 election, which had strengthened his party's majority in the Senate by two seats. As he had done on several key pieces of legislation in 1996, Lott was the man who could muster his troops to deal with the president. Perhaps most important, he had not been a party to the confrontations and failed negotiations of 1995–96. He had been granted a fresh start as Republican leader at the most propitious time.

Tuesday, January 28, 1997

Reaching Senator Lott by phone, I pressed him on the budget. He was happy to report that he and the president had indeed been talking a balanced budget and wanted to push ahead. That was Lott's legislative strategy: push, push, push. Don't sweat the little stuff, just get it done. He was taking the same approach to the president. He even suggested that the two of them should agree to the outlines of a deal and then push it through Congress.

But that would not work. In 1996 the Republicans had cooperated with the administration because they feared political obliteration—payback for government shutdowns and a lack of accomplishment. Now they were back, stronger and more conservative in the Senate. Moderates like Senators Nancy Kassebaum of Kansas, Mark Hatfield of Oregon, and Bill Cohen of Maine had retired, and Lott's more conservative caucus would want to assert itself. No budget deal could be cooked over the phone or in the back room. For an agreement to carry, all four party caucuses in Congress would have to be fully engaged.

That evening, the president's senior advisers gathered for the weekly White House political meeting in the Yellow Oval Room, a large comfortable room on the second floor of the White House residence looking directly out to the Washington and Jefferson memorials. It was here that the president, the vice president, and twenty or so of the president's top advisors had met over the past year to put their collective efforts into one overriding objective—victory in the November elections. With that goal achieved, it was time to govern.

Walking to the meeting from the Oval Office, I told the president of my conversation with Lott. His first reaction was to talk about anything but the budget—a mini-filibuster. He had been found out and he knew it. Finally, I was able to convey a few simple points: After 1995–96 we were dealing from strength; a secret budget deal with Lott would undermine us with congressional Democrats, who would be outraged at their exclusion from the process; and our early outreach to Democrats and Republicans had to include the guys who understood the budget—Domenici and Kasich and their Democratic counterparts, Lautenberg and Representative John Spratt of South Carolina. Otherwise any deals that were reached might soon crumble.

During the meeting, the political team focused on second-term initiatives and the State of the Union address.[11] In these early days of 1997, it was all good news. White House polls showed that 57 percent of those surveyed thought the nation was on the right track, compared with 35 percent who thought it was on the wrong track. The president's favorability rating was 67 percent, while Speaker Gingrich's was a dismal 33 percent. Now was the time to capitalize on the public's support by adopting policies that were close to Democrats' hearts. More than fifty possible initiatives were on the table, ranging across the spectrum—a balanced budget, the HOPE scholarship for postsecondary education, expanded health care for children, tax cuts, welfare-to-work proposals, technology investments, environmental clean-up, consumer protection, more cops on the street, drug abuse prevention and enforcement, shored-up pensions, improved race relations, foreign affairs. It was an expansive agenda, destined to be delivered in rapid-fire, laundry-list fashion in the State of the Union.

But most important, the president was intent on setting a constructive tone. He would be forward looking and magnanimous and offer the hand of bipartisanship, perhaps opening the way to a constructive engagement with the Republican Congress. Both parties had strong incentives to finish the job of balancing the budget. For Democrats, a balanced budget would free them of the big spender bogey, shifting the public's focus to the party's strengths in education, health care, environment, and public investments. The macroeconomic arguments for balancing the budget were also compelling. The baby boomers with their impending claims on Social Security, Medicare, and other social programs would soon place the country—and the federal budget—under extraordinary financial stress. The federal budget needed to increase, not reduce, national savings if future generations were to be prosperous enough to honor those collective promises.

Republicans had their own reasons for wanting a balanced budget. It would fulfill one of the central pledges of the Contract with America and prove that the Republicans could be fiscally conservative while achieving several policy objectives, including tax cuts and reductions in government spending. And if the budget turned to surplus, the stage would be set for further rounds of tax cuts in the following years.

AFTER THE MEETING, I alerted Erskine to the president's intramurals with Lott. The president came clean, and Erskine raised the same warning flags. A backdoor agreement with Lott would cause a firestorm among Democrats who favored partisanship over a bipartisan budget agreement. To top it off, a quick deal with Lott likely could not carry the Republican House. When it came to budget matters, House Republicans were not used to playing second fiddle.

One thing was clear: it was time to ramp up and catch up with the president. We would have to help keep the boss pointed toward a bipartisan agreement. That would require us to accelerate and deepen our conversations with Republicans. OMB director Frank Raines and I would reengage Domenici immediately with the hope that our discussions with him would keep Lott from jumping too far ahead. If Domenici became the point man, the White House would be dealing with the expert on the budget who understood the nitty-gritty of policies and programs and where the compromises might lie. We agreed that I would also meet with John Kasich privately even though we knew our quiet shuttle diplomacy could not last for long. Secret talks would need to yield to a more inclusive process; the two sides would have to engage in the open. But that coming into the open—the handoff—would be very tricky. The participants were leery of each other and had different agendas. Our quiet outreach was intended to point the key players in the same direction—hoping they would take ownership of the process once they were convinced that their efforts could bear fruit.

Thursday, January 30, 1997

John Spratt was the newly elected ranking Democrat on the House Budget Committee.[12] He was an immensely popular member, and with good reason. Sincere and kind, he lacked pretension and was very smart in a nonthreatening way. He had a facility with numbers and budget concepts and was a quick study. In budgetary matters, he was allied with the House Blue Dogs, a group of conservative Democrats who believed in tough budgets, opposed tax cuts, and were much less afraid to cut spending than were their caucus colleagues. But now he had a broader mandate—to represent the House Democratic caucus. Although a moderate, he had earned the trust of those who were more liberal. And he was a friend of Erskine. From the White House perspective, he was the right person in the right place.

Spratt was frustrated with Kasich, his Republican counterpart, and more broadly with the difficulty of communicating with House Republicans. He was picking up signs that unlike the Republicans in the Senate, the House Republicans did not yet have a game plan. Spratt also worried that with the president and Republicans on record favoring tax cuts, there could be a bidding war leading to a replay of the fiscal hemorrhage begun in 1981. And he feared that neither Congress nor the White House would muster the courage to make the necessary spending cuts. He told me that Republicans might grab a few Democrats and enact a Republican budget that was anathema to the majority of House Democrats. But it was clear he was really talking about something different. No significant number of Democrats would abandon their party for a simple reason: the conservative Democrats who liked the Republican spending cuts hated the Republican tax cuts. No, what John Spratt was really saying was that he and other Democrats were worried about the White House—worried that the president might reach an agreement with the Republicans and leave congressional Democrats in the lurch.

Friday, January 31, 1997

Meanwhile Senator Lott had given us the green light to engage Domenici as his deputized budgeteer. Frank Raines and I came to the Hill separately and convened with Domenici and Hoagland in his office in the Hart Building, away from the Capitol and the press.

I arrived first, late in the afternoon. Domenici was dressed casually, sipping red wine from a paper cup. In the first minute he laid out his personal stakes, declaring openly, "My reputation is on the line." He had proven himself numerous times, but he could not rest on his reputation; it was a new day, a new caucus, and a new leader.

At the opening of budget season, Domenici was worried about all the moving parts. Numerous political and budget factions would be competing to leave their imprint on any budget agreement. In the Senate there was the bipartisan Breaux-Chafee group whose budget plan had garnered forty-six votes the year before.[13] In the House, there were the austere Blue Dog Coalition, the liberal Democratic Study Group, the moderate Republican Lunch Bunch, the in-the-middle New Democrats, the Black Caucus, the Hispanic Caucus, and more. All would have to be engaged.

This task would be all the more difficult because we all understood that a bipartisan agreement could not be a normal budget resolution setting only the overall levels of revenues and spending. Given the political differences between the parties, the administration could not simply announce an overall agreement and then leave it to the Republican Congress to enact the specific policies. In critical areas such as Medicare, taxes, welfare, and immigration, negotiators in the White House and Congress would have to agree on both the policies and the numbers. And everyone would need to pull together to make sure the committees followed behind and actually enacted the agreements.

This sounded fine, if optimistic, in the Senate. But what about the House, I asked? Domenici's answer was detached from the reality he knew so well. His response: once the White House and key senators had an agreement, Lott would take the deal to House Speaker Gingrich who would deputize Kasich to mobilize the House to follow. This was what Lott had been telling the president; work with us, and the House will follow. But there was no way this scenario was going to happen. The Constitution empowers the House of Representatives to initiate spending and tax bills, and it had been in the driver's seat on the last major budget round. Did anyone think Gingrich and Kasich would swallow a Senate–White House deal? Given the apparent lack of communication between Senate and House Republicans, it was clear that the White House would need to expand its quiet outreach to all sides.

Monday, February 3, 1997

On "Meet the Press" over the weekend, Senator Lott had invited the president to come to the Hill the day after Tuesday's State of the Union address to discuss ways the Democratic president and the Republican-controlled Congress could work together. The invitation was constructive, a first public reaching across the aisle. But conflicting schedules meant that the meeting would have to be delayed a week. And what was Lott hoping to accomplish, what was his agenda?

At his Capitol office, Lott told me that his call for a leadership meeting was just what it seemed—an effort to get the sides engaged, for the participants to talk about their legislative priorities, and perhaps start a process leading . . . somewhere. This was the Senate leader we liked: move quickly, get the balls in the air.

Senator Lott said he was not tied to the regular order—the normal deliberative process in which legislation is introduced, referred to committees, and considered and reported for consideration by the whole House or Senate. He was a risk taker and believed in "finding a seam and driving through it." I knew he must have uttered those same words to the president. He was a deal maker at heart, strong on the close, but not overly interested in the details. He did not like sitting through the long back-and-forth and nitty-gritty of negotiations. He would sometimes leave the room, return in a few hours, and upon reentering demand to know in a good-natured way what the hell was taking so long.

Republican Senators were lined up behind his bipartisan overtures. But what about the House? His answer: "Newt knows I'm up to something and can be brought along." But that sentence contained two contradictory notions. One had Gingrich on the inside; the other had Gingrich in the dark. Well, how about Kasich, I asked? He groped for words, finally saying that with Gingrich on board, they could get Kasich to come along. I held my counsel but knew that would not work. In House budget matters, the path ran the other way, from Kasich to Gingrich. It was Kasich who exercised an almost compelling influence on the budget. He was chairman of the House Budget Committee, but more important, he was the true believer and the real expert. Kasich was the central figure who would have to validate an agreement and provide the foundation on which Gingrich would build his political support.

When I returned to the White House, Erskine asked how long it would be before anyone discovered our quiet shuttle diplomacy. That would depend on the number of people we approached and who they were, I said. Domenici and Hoagland were used to working quietly and there was little chance that they would slip up. But the president or Senator Lott could be too open; they enjoyed talking to each other, to friends, and to colleagues.

Moreover, we were accelerating our activities and needed to expand the outreach and negotiating team. That process would start with Bob Rubin. A former Wall Street financier who had served as head of the president's National Economic Council, Bob had become the most influential member of the cabinet since succeeding Lloyd Bentsen as Treasury secretary in 1994. More than any other cabinet secretary, he was a part of the White House team, a central figure in the inner circle. Erskine would bring him into this one.

Tuesday, February 4, 1997

It was time to roll up the sleeves with Domenici and Hoagland, taking the view from a very long perspective. These men had been a part of the now-sixteen-year effort to repair the fiscal damage caused when an enormous breach was opened in the nation's finances in 1981. At that time, the Reagan administration, the Republican-controlled Senate, and the Democratic-controlled House of Representatives jumped outside the normal budget bounds, enacting massive tax cuts that proponents claimed would be largely self-financing. Citing the principles of supply-side economics, they argued that tax cuts would boost economic activity and ultimately generate more tax revenue. Any remaining budgetary shortfall, they promised, would be covered by cutting government spending—even though President Ronald Reagan was firmly committed to major increases in defense spending. As it turned out, both the self-financing of the tax cuts and the spending reductions proved to be illusory, and despite a decade of congressional efforts to turn the tide of red ink, $1.4 trillion was added to the national debt between 1982 and 1989.

By the end of the 1980s deficits were rising and projected to increase further. Into the breach stepped President George H. W. Bush. He provided the political leadership that made it possible for Congress to enact a massive, $500 billion, five-year deficit reduction package in November 1990.[14] To achieve this goal, he was forced to repudiate what had been perhaps the central message of his successful 1988 campaign—his pledge not to increase taxes.[15] In a tumultuous political year, President Bush shepherded the passage of the bill, despite the defection of House Republicans over tax increases that accounted for 30 percent of the deficit reduction. But the president was not rewarded for his fiscal virtue. A weakening economy drove the deficit higher and undermined his bid for reelection. His loss to William Jefferson Clinton in 1992 strengthened the antitax resolve of the emerging Republican congressional majority. From their viewpoint, Bush had committed the unforgivable political error of following the Democrats into the tax briar patch.

When President Clinton took office in January 1993, the fiscal outlook was bleak. The new president inherited a stunning amount of red ink, with the federal budget deficit projected at $1.8 trillion over six years, according to CBO.[16] Repairing the fiscal damage became the administration's number one priority—in line with the message of "It's the economy, stupid," that had been the centerpiece of the president's campaign. But the prospects for a bipartisan approach were doomed by the inclusion of significant tax increases in President Clinton's first budget proposal.

The administration's first budget reduction effort was manna from heaven for the Republicans, who were intent on capturing Congress. Not a single Republican voted for President Clinton's 1993 budget package. Enactment was secured with Democratic votes only, including the tie-breaking vote of Vice President Al Gore acting in his capacity as Senate president. Partisanship ran rampant as Republicans accused Democrats of raising taxes rather than cutting spending to reduce the deficit—although the $500 billion, five-year deficit reduction package was equally split between spending cuts and tax increases.[17] These attacks paid off in the 1994 midterm elections, which gave Republicans control of both chambers when the 104th Congress convened in January 1995.

Once in power, House Republicans moved swiftly to implement their campaign platform, which had been astutely packaged as the Contract with America.[18] The contract laid out a sweeping agenda to balance the budget, cut taxes, reform welfare, strengthen national security, grant regulatory relief, and implement congressional reform and terms limits, among other priorities. At the center of the Republican program was the commitment to balance the budget while cutting taxes. With Social Security, which amounted to 22 percent of the budget, off the table, that meant that the rest of government would have to absorb nearly $900 billion in spending cuts over seven years.[19]

In a legislative tour de force, the Republican-controlled House rode roughshod over the opposition to pass the major components of the Contract with America—including the tax and spending bills—in the first hundred days of the 104th Congress. In quick succession, the House passed legislation that cut spending on major entitlement programs, including Medicare and Medicaid, as well as funding for many of the government's core services. The Republican-controlled Senate then tweaked the program, setting the stage for a confrontation with the White House and congressional Democrats.

In the ensuing test of wills, neither side blinked. President Clinton vetoed the Republican budget package, arguing that it cut too deeply into the government's core functions and distributed the benefits of tax cuts largely to the well-to-do. The Republicans held their ground, maintaining that their budget rightly reduced the scope of government and let taxpayers keep more of their hard-won earnings. In the face of the two sides' refusal to compromise, the federal government was forced to shut down, not once, but twice—in November and again in December 1995. President Clinton refused to sign legislation that so altered the nature and responsibilities of government, and the Republicans refused to fund a bill that didn't. Finally, the public rebelled, assigning blame for the standoff to the Republican Congress and demanding that the government be reopened. On January 6, 1996, the Republicans presented, and the president signed, a funding bill without the deep cuts the Republicans had advocated.

But now in 1997, thanks to the brave but politically perilous efforts of George H. W. Bush in 1990 and Bill Clinton in 1993—and to a booming economy that was filling the Treasury with revenue—the long-sought goal of a balanced budget was in sight. The remaining gap could be eliminated by spending cuts alone, which meant that tax increases could be taken off the table.

Frank Raines and I outlined the president's budget proposal to Domenici and Hoagland (table 1-1).[20] It was a budget that had been worked to death for months inside the White House, in cabinet agencies, and with key Democratic leaders and committees on the Hill. It was a masterpiece of politically informed

Table 1-1. *President Clinton's Proposed Savings for FY1998 to FY2002 Using the OMB Baseline*

Item	*Proposed savings*
Net reductions in discretionary spending	$137 billion
Defense	*$79 billion*
Nondefense	*$58 billion*
Reductions in Medicare spending	$100 billion
Reductions in Medicaid spending	$9 billion
Receipts from spectrum auction	$36 billion
Net mandatory spending increases	($24 billion)
Net interest savings	$16 billion
Net spending cuts	**$274 billion**
Net tax cut	($22 billion)
Net deficit reduction	**$252 billion**

Source: OMB, *Budget of the United States Government: Fiscal Year 1998* (GPO, 1997), table S-4.

policy that reinforced the support of our core Democratic constituencies even as it left room for the necessary compromises with Republicans.

Under OMB's deficit projections, enactment of the president's program would turn a projected deficit of $100 billion in 2002 into a $17 billion surplus. Over the five-year budget window, the president proposed a total of $274 billion in net spending cuts. Of that amount, $252 billion would go toward deficit reduction and $22 billion would pay for a net reduction in taxes.

The bulk of the $274 billion in net spending cuts would come from four big categories: reductions of $100 billion from the Medicare program, $79 billion from defense spending, and $58 billion from nondefense (domestic and international) programs funded annually through the appropriations process; and receipts of $36 billion from the government's auction of portions of the electromagnetic spectrum to private users. Those big pieces, along with other savings, allowed the budget to pay for a small tax cut and numerous presidential spending initiatives while still coming into balance.

The administration had labored for months to achieve a net reduction of $58 billion in nondefense discretionary spending while allowing targeted programs in that category to grow in such areas as education and training, the environment, crime and enforcement, and science and technology (box 1-1). The administration also proposed new spending initiatives in entitlement accounts that would provide health coverage for children and for families between jobs, encourage employers to hire those on welfare, restore benefits denied legal immigrants under the 1996 welfare reform legislation, and fund

Box 1-1. *Selected Domestic Spending Initiatives in President Clinton's FY1998 Budget Proposal*

HEALTH. Expand health insurance for children and the temporarily unemployed; increase funding to the National Institutes of Health for research on AIDS, breast cancer, and genetic medicine; expand funding for substance abuse and mental health programs; increase support for the Centers for Disease Control and Prevention.

EDUCATION. Modernize schools; upgrade teaching and learning standards; increase the number of tutors for child reading; link every school to the Internet; support remedial and special education; expand grants and loans for low-income college students; raise funding for the Job Corps, youth summer employment, and Head Start.

ENVIRONMENT. Fund Superfund hazardous waste cleanups and brownfields cleanups, to enable redevelopment of industrial sites.

IMMIGRANTS. Restore Medicaid and Supplemental Security Income payments to qualifying legal immigrants who were in the United States before enactment of the 1996 welfare reform bill.

TECHNOLOGY. Fund the advanced technology program, the manufacturing extension project, and national infrastructure grants to link to the Internet.

DEVELOPMENT. Increase funding for community development block grants for urban renewal and housing, empowerment zones and enterprise communities, and urban cleanup.

CRIME. Increase funding to the FBI, Drug Enforcement Administration, and Border Patrol; initiate grants to the states to put an additional 100,000 police officers on the nation's streets.

Source: OMB, *Budget of the United States Government: Fiscal Year 1998.*

school construction. Finally, the president's proposals used the tax code to achieve several policy objectives, aimed at expanding college education, extending health care to low-income children, giving homeowners a tax break on their principal residence, encouraging workers to save more, and encouraging businesses to hire former welfare recipients (box 1-2).

Box 1-2. *Selected Tax Cuts in President Clinton's FY1998 Budget Proposal*

HOPE SCHOLARSHIP. Allow a $1,500 per year tax credit for the first two years of postsecondary education for families earning less than $100,000 a year.

LIFETIME LEARNING DEDUCTION. Allow an income-tested $10,000 tax deduction for postsecondary education expenses, including job training.

CHILD TAX CREDIT. Allow a $500 per year tax credit for children under thirteen for families with income under $75,000.

CAPITAL GAINS. Waive taxes on capital gains up to $500,000 on the sale of a homeowner's principal residence.

INDIVIDUAL RETIREMENT ACCOUNTS. Increase the limits on the amount of income that can be set aside for traditional pretax IRAs; establish an income-tested tax-deferred IRA.

TAX INCENTIVES. Allow targeted tax incentives to businesses for pollution cleanup, investment in inner cities and the District of Columbia, and the hiring of long-term welfare recipients.

Source: OMB, *Budget of the United States Government: Fiscal Year 1998.*

In response, Bill Hoagland gave us a one-pager with nine lines and seven columns of numbers. (For the basics of the Republican plan, see table 1-2.) Their initial proposal contained not a word of description. But the gulf between their position and ours was apparent. At the start of this good-faith effort, the two sides were once again miles apart. The Republicans would cut Medicare and Medicaid and domestic discretionary funding far deeper than the administration would. They had to. They were using tougher CBO deficit projections while also making room for tax cuts that went well beyond those proposed by the Clinton administration. Even with all this politically imprudent cutting, they were still $22 billion short of balance in 2002. No wonder Domenici wanted to reach outside the normal budget box and adjust the consumer price index downward, knocking billions of dollars off the deficit—and out of the pockets of millions of Americans.

Table 1-2. *Senator Domenici's Initial Proposed Budget Plan for FY1998 to FY2002 Using the CBO Baseline*

Item	*Proposed savings*
Freeze defense and nondefense discretionary spending	$217 billion
Reductions in Medicare spending	$158 billion
Reductions in Medicaid spending	$22 billion
Other mandatory savings	$49 billion
Net interest savings	$48 billion
Net spending reductions	**$446 billion**
Net tax cut	($108 billion)
Net deficit reduction	**$386 billion**

Source: Republican offer sheet prepared by Senate Budget Committee majority staff.

The four of us—Domenici, Hoagland, Raines, and I—started looking for areas of agreement. We were close on defense spending. Some Democrats would feel the number was too rich, but with U.S. troops in Bosnia and the nation's worldwide commitments, defense would not be a battleground in this year's budget. After the fall of the Iron Curtain in 1989, the nation was eager for a peace dividend, and America's leaders had given it to them. Defense spending peaked at $320 billion in 1991 and then fell steadily over the next five years, to $266 billion in 1996.[21]

Then Domenici launched a trial balloon, saying that the difference between the OMB and CBO deficit projections was not as great as it might seem. Fully half the difference was the result of a judgment call on an arcane economic assumption affecting corporate tax payments. Forget whose judgment call would turn out to be more accurate, Domenici was opening a door—indicating a willingness to move toward the administration's less pessimistic deficit projections.

If that was to happen, Frank and I knew Domenici would want something in exchange. He was not a supply-sider; it would not be "self-financing" tax cuts. Domenici had worked too long and hard cleaning up messes to believe in free lunches. What he wanted was "entitlement reform," code words for reducing spending on Medicare, Medicaid, welfare, and other programs whose spending flows from formulas set in law. Unlike government programs that are funded yearly, entitlement spending is automatic. If you meet the eligibility requirements, you are entitled to get the money.

Entitlement programs make up most of the federal government's social safety net, with Social Security, Medicare, and Medicaid being the largest.[22] Social Security, a cornerstone of Franklin Roosevelt's New Deal, was enacted in 1935 during the Great Depression; it provides income for retirees with a sufficient work history, as well as income for the disabled. Both Medicare and Medicaid were part of President Lyndon Johnson's Great Society. Medicare funds health care for seniors, and Medicaid provides grants to states to support health care for the poor. Other major entitlements include unemployment insurance, farm price supports, and means-tested programs such as food stamps and Supplemental Security Income (SSI)—cash that is given to the very needy. Entitlements were a growing share of federal expenditures, with the fastest growth in the area of health care—caused by more enrollees, more generous benefits, and sharply rising health care costs.[23]

Entitlement spending had become a flashpoint for competing philosophies of government. The differences tended to follow party lines, but not always. To many Republicans and some Democrats, entitlements were a blank check on the Treasury. They increased spending automatically, and once under way with their vested beneficiaries, the programs were difficult to rein in. The programs were viewed by some as an inevitable path to an expanding government, one that would make ever greater claims on the Treasury and the economy.

The other side of the argument was that entitlement spending was the proper means to fulfill society's commitments. If the collective judgment of the nation's citizens was that government should provide pensions in the form of Social Security, health care through Medicare or Medicaid, or other forms of support, then entitlement spending was an appropriate way to fulfill those promises. A retiree's Social Security check or health care should not be held captive to the whims of the economy, a fickle Congress, or the latest budget impasse. Entitlements are thoroughly democratic because no privileged position or special favor is required to qualify. If you meet the standard, you are in.

On the question of entitlements, Domenici's position was not in doubt. His sheet of numbers could not have been clearer. Over the five-year window, he would reduce Medicare by $158 billion, Medicaid by $22 billion, and other entitlements by $49 billion. If he had his way, over half the deficit hole would be filled from these programs. And if a CPI adjustment were included, these entitlement cuts would skyrocket.

He had kept his counsel on the president's budget proposal until the end of the meeting, but he could no longer resist. What was the White House doing suggesting $62 billion of new entitlement spending?[24] Weren't we supposed to be reducing existing programs, not starting new ones? We let it pass. It was getting late and the president's State of the Union Address was that evening. We would convene again on Saturday, off-campus at Frank's house.

Wednesday, February 5, 1997

The president's State of the Union address hit the right chords. "The people of the nation elected us all. They want us to be partners, not partisans. They put us all here in the same boat, they gave us all oars and they told us to row."[25] As was his custom, he went through his extensive set of initiatives: education, health care for kids, a welfare-to-work program, anticrime initiatives, environment, national service, and on and on. A very full agenda, but all of it paid for within his balanced budget.

The launch of the budget would follow the State of the Union address by two days. So Wednesday was a critical day to make the rounds. Erskine and I would meet with Senate Democratic leader Tom Daschle of South Dakota, and I would visit with John Kasich by myself. And on the day of the launch, the president would host one of his semi-regular meetings with the two Democratic leaders, Daschle and Representative Richard Gephardt of Missouri.

Senator Daschle was entering his third year as leader. After Democratic leader George Mitchell of Maine retired in 1994, Daschle had won the leadership race by a single vote, with most of the senior members of the Senate Democratic caucus supporting his opponent, Senator Chris Dodd of Connecticut. From that tenuous beginning, Daschle had solidified his position in the caucus. He had had a remarkably successful first two years, proving to be not only a consensus builder within the caucus, but a tough and able adversary. He was nominated for his second term by Senator Robert C. Byrd of West Virginia, the most senior and, at one time, the most powerful Senate Democrat.

Daschle was a trusted ally of the White House, and we quickly brought him along on Republican leader Lott's intentions on the budget. In public Lott had been talking regular order—receive the president's budget, let the Senate Budget Committee do its work, and then take the long march through the rest of the committees. But in private, as we told Daschle, Lott was promoting a quick agreement with the White House.

Daschle reported that Democrats in Congress saw no advantage to an early sit-down with Republicans. They were hell-bent on making the Republicans come up with their own budget—in public. The most recent slight riling Democrats was the introduction of the Republican tax bills, posted as S1 and S2 on the Senate calendar, proposing unrealistically large tax cuts of $193 billion over five years.[26] The Democrats' reaction was swift and predictable. If the Republicans were serious about their tax cuts, then let them produce a budget that paid for it all. They would have to cut spending deeply, including the programs they had been skewered on just a year earlier. And if, as everyone knew, they could not possibly produce a budget with those large tax cuts, Democrats would make them eat their words.

But forcing Republicans into the open would not be so easy—nor necessarily advisable. There was no legal requirement to reduce the deficit, no deficit targets that had to be hit. If partisanship really took hold, Congress would simply take a pass on the tough decisions to balance the budget. The appropriations committees could be turned loose to draft their annual funding bills, and that would be it. Congress could get out of town without a meltdown and with no deficit reduction. The Democrats could not make the Republicans walk off a budget cliff. Only they could do that, and our White House budget team was sure they had absorbed the lessons of their failure in 1995.

KASICH WAS FINALLY back in town, and just in time. "So, John," he said, "tell me what we ought to do." White House staff had been engaged with Domenici for two weeks but was running late with Kasich. The president's budget plan would be out tomorrow, and we needed Kasich to be part of a bipartisan solution. There was no time to lose.

I told him that in his position, I wouldn't have a clue what to do. The president's budget only got to balance because it used OMB rather than CBO deficit projections. The difference between the two projections came to more than $65 billion in the last year alone. So the Republicans, using the CBO numbers, were starting with a bigger deficit to fill, and they wanted a bigger tax cut, costing probably $20 billion to $30 billion in the last year. Some of the savings in the president's budget had little chance of enactment, so that was another $10 billion that had to be found somewhere. To balance the budget, the Republicans would need up to $100 billion more savings in 2002 alone, and about $300 billion over the five-year budget window. And they had no easy way to fill the deficit hole. They could not politically afford to run the Medicare gauntlet again, could not make the CPI adjustment without holding hands with the White House, and would not dare cut defense spending.

Kasich paused, smiled, and then let out a big laugh, "So you're telling me we're screwed!" As he and I started back over the numbers, I was amazed that he had not yet fully focused on the challenge of putting all the pieces together. Kasich started to push back, criticizing previous Democratic budgets, questioning the president's dedication to deficit reduction. Why not stretch to hard numbers and give ourselves the best chance of success, he asked. He wanted to use CBO numbers and to err on the side of caution—and on the side of the deeper spending cuts he favored.

We all had been down this road before. In the budget standoff of 1995, Republicans had insisted that the president produce a balanced budget plan under tougher CBO numbers. When President Clinton did just that in January 1996, Kasich and others dismissed it as too little, too late. I told Kasich that if the Republicans had claimed victory then and passed that balanced budget, they would have validated their budget crusade and could have justified, if not erased, the memories of the government shutdowns that had so tarnished their party.

"You know, one of the reasons that 1995 didn't work is that Pete Domenici and I were left out of it," Kasich commented. He was acknowledging opportunities lost, but he was also laying down the rules for this year's hoped-for agreement. When the budget negotiations moved to the White House in late 1995, Domenici and Kasich had been relegated to the back room, while the president, Senate majority leader Dole, and House Speaker Gingrich tried their hand at deficit reduction. As the negotiations began to rush toward collapse, the two budget committee chairmen became accomplices to the failure, upping the ante on what was being demanded of their leaders. In the end, no one's deal would have been good enough.

But now was a new day, and all of us were hoping to avoid repeating the many mistakes of the past. Kasich agreed to meet on a confidential basis—neither of us would share information without the permission of the other. One of the key players in the House was joining a team on which he had not been given the full roster of teammates nor all the avenues those teammates were pursuing. This is the result the White House team had been hoping for. For the time being, the lack of communication and coherence on the Hill suited us just fine, as long as those paths ultimately led to an agreement.

THAT AFTERNOON, THE White House budget and economics team gathered in the residence to brief the president for the following day's release of the budget. Erskine asked me to begin. I said that we were in a good political position. We had a sound budget and could deal from strength. The Republicans were traumatized by the 1995 budget meltdown and would have great difficulty moving a serious balanced budget by themselves, especially one that used CBO deficit projections and contained tax cuts. But the Republicans were open to a compromise, and we had already engaged some of their key people. Domenici and Kasich wanted to be inside the tent.

I warned that we had to be extremely mindful of congressional Democrats. The agreement had to win a strong majority of Democrats in both houses. For them, the tax cuts would be hard to swallow unless they had clear victories on education, health, and other high-priority issues. In addition, congressional Democrats were not ready for a sit-down with the Republicans. It would be unwise for the president and Lott to run too far ahead.

Frank Raines followed with the numbers. If we were forced to use CBO numbers, if we split on taxes, if we got our priorities, the budget would remain billions out of balance. The president absorbed it all; he understood the federal budget as well as anyone. In preparing his first budget submission in 1993, he had gone line by line through the whole thing. In areas he had dealt with as governor of Arkansas such as welfare, education, and other social services, his knowledge surpassed that of the policy experts. He also had a remarkable facility with numbers. He said passing this budget agreement would be tough but easier than the failed attempt of 1995. If we had to split the differences to get a balanced budget, we would. As the meeting came to an end, President Clinton gave his blessing to continue our multiple channels, both in the open and underground.