

THE BROOKINGS INSTITUTION

"RESTORING FISCAL SANITY:
HOW TO BALANCE THE BUDGET"

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Falk Auditorium
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Washington, D.C. 20036

[TRANSCRIPT PREPARED FROM A TAPE RECORDING.]

PANEL 2:

MODERATOR:

RON HASKINS
Senior Fellow, Economic Studies, Brookings

PANELISTS:

ROBERT E. RUBIN,
Director and Chairman of the Executive Committee, Citigroup

JOHN EDWARD PORTER
Partner, Hogan & Hartson, LLP

ROBERT D. REISCHAUER
President, Urban Institute

DAN L. CRIPPEN
Former Director, Congressional Budget Office

QUESTION AND ANSWER SESSION

PROCEEDINGS

MR. HASKINS: Thank you for coming. Now, we get to pose some questions of, I would say, a fairly decent panel to respond to these issues.

[Laughter.]

MR. HASKINS: We have a tradition here at Brookings that we include lots of biographical information in your packets, and we give very short introductions. This is primarily because, on rare occasions, we have Republicans who introduce Democrats, and they might get carried away, so we want to make sure that doesn't happen.

So, in this order, we're going to begin with Bob Rubin. Bob Rubin is a former Secretary of Treasury and the Co-Chairman of Goldman Sachs, and he is currently the Director and Chairman of Citigroup;

John Porter, on my left, is a former Congressman from Illinois, but more to the point, he was the Chairman of the Labor and Health and Human Resources Subcommittee of the Appropriations Committee, one of the cardinals, so to speak. He is currently a partner in Hogan & Hartson here in Washington, D.C.;

Bob Reischauer, who is also a former Director of the Congressional Budget Office and, equally important, a former senior fellow here at Brookings, and he is now President of the Urban Institute;

And, last, Dan Crippen on my right here, who is also a former Director of the Congressional Budget Office, and he was a founding partner in the Duberstein Group. He is now a private consultant.

Here is our procedure. Each of the panelists is going to have seven minutes. They can either use the podium or stay seated, and upon the conclusion of those seven minutes of comments, I'm going to pose some dastardly questions, and then we'll have about 30 seconds left for audience participation.

[Laughter.]

MR. HASKINS: So that's our plan, and we're going to begin with Robert Rubin.

MR. RUBIN: Thank you.

I will follow up on what Alice and Bell had to say and, to some extent, my comments will relate to theirs and, to some extent, it may go off a bit into a slightly different direction.

If you look at virtually all mainstream economists, I think it's fair to say that they would hold that there is a significant relationship between long-term deficits and interest rates.

At the American Economic Association meeting of a week ago past Sunday, Alan Sinai, of Decision Economics, Inc.; Peter Orszag of Brookings; and I presented a paper, with Peter being our presenter, that was entitled, "Sustained Budget Deficits: Longer Run U.S. Economic Performance and the Risk of Financial and Fiscal Disarray."

And what it did was to discuss the conventional analysis of the effects of long-run deficits and then, recognizing that those conventional effects are indeed serious, went on to discuss the potential for exceeding those conventional effects.

Today's conference relates to that analysis, and you heard Alice I think present it exceedingly well, and then goes beyond that to discuss some possible responses to what is now a horrendous long-term fiscal situation. And if nothing else, it seems to me, as Alice said, this should provoke debate, and it does demonstrate how difficult, both substantively and politically, dealing with the deep hole that we are now in will be.

I'm not going to repeat here the paper that we presented a week ago this past Sunday, but let me just briefly list the effects in summary form.

The first is the conventional analysis, which Alice referred to, which is that the government demand for capital crowds out private sector demand. That, in turn, reduces private sector investment and reduces productivity, which reduces growth over time. And of course the intermediating factor to bring equilibrium back is higher rates, which can also adversely affect demand, reducing consumption and reducing investment.

Beyond that, there are the effects that go beyond this conventional analysis, and in my judgment, at least, I think those effects have the potential of being far more serious, and far more severe, and should be far more troubling.

I worked in markets for 26 years before I went into the government. It's the world that I've been part of my entire adult life. I think that when you face the kind of deficits that we face today, what you have is a serious risk that at some point the markets may begin to believe that the government is going to resort to inflation, rather than fiscal discipline, to deal with debts and to deal with fiscal deficits.

And reacting to that, the markets will begin to demand a sharp increase in interest rates, over and above that projected through conventional analysis in order to compensate for that risk of resorting to inflation.

Secondly, I think there is also a risk--and Alice alluded to this--that the international markets could lose confidence in our currency because of our long-term fiscal regime and also because of our large current account deficits, which, as you all know, are partly a function, again, of our fiscal ill discipline.

As a consequence, there is the risk that, in addition to the gradual kind of adjustment in our currency that you might have expected because of our large current account deficit, there is the risk that the international markets will begin to demand sharply higher interest rates in order to compensate for the risks, both currency risks and interest rate risks that I've just mentioned.

There is also the risk that they will become reluctant to engage in the rollover of the very large amounts of U.S. dollar-denominated Treasury debt now held abroad, except, again, at much higher interest rates.

Another item in the list of nonconventional effects. As happened in the early 1990s, the deficits could come to be seen as evidence of a more general inability of our society to deal with its economic issues, and as a consequence, could begin to undermine business and consumer confidence more generally, which I believe is what happened in the early '90s.

Furthermore, all of these effects could happen together, and any one of them individually could create serious additional problems over and above the conventional analysis. Put them all together, and you could have a very severe set of effects.

There are various models that attempt to quantify the conventional kinds of effects. I don't think there is any way to reasonably get at trying to quantify these nonconventional effects, and that, unfortunately, makes it much more difficult to convey them in a public domain and to create what I think would be a totally appropriate, terribly troubled public reaction, which in turn could help feed our political process. But in my judgment, there is no question that the risks are severe and need to be taken with great seriousness.

As Ball and Mankiew said in a 1995 paper warning of a similar set of effects, and I now quote, "We don't want to see what this means in a G7 economy."

All of these effects or risks, rather, exacerbated by the beginning of the retirement of the baby boomers the latter part of this decade, which will increase the deficits with every passing year.

We are also now a large debtor nation, so that foreign capital sources are heavily weighted toward the dollar and also have to make decisions on rollovers on a constant basis. That increases the level of confidence that we need to have abroad in our fiscal regime.

And, finally, as the investment banking firm of Goldman Sachs & Company said, I think it was a couple of months ago, in the first sentence of a recent report, and I quote, "The United States budget is out of control."

On this last point, the 2001 and 2003 tax cuts, assuming the tax cuts are made permanent, as the advocates propose, and assuming the debt service would cost about \$3 trillion over the next 10 years, if you take the deterioration in our projected fiscal position, since the CBO projections of January of 2001, that deterioration is about \$9 trillion. It is actually \$11 trillion, but if you adjust for various methodological issues, it's a deterioration of about \$9 trillion. That \$3 trillion is directly responsible for one-third of it.

And I think there's an indirect effect which may be even more important, which is I think once you have those very large tax cuts, particularly that favor the most affluent, it is very hard--I think it has proved to be impossible, actually--to maintain the always fragile political coalescence around fiscal discipline.

The timing of these effects is impossible to predict. As long as there is relatively little demand for private investment, I believe, from all of my experience in markets, that you will have, as you indeed have had over the last two years, low interest rates. The problem is, once you have strong demand, strong private-sector demand for investment, that will collide with the deficits. And then at some point I don't think there is any question that the markets will look forward to the unsound fiscal conditions now projected and that you will begin to have, and in very large measure will have, the kinds of effects that I've just described, and the risks will become a reality.

Let me conclude by saying that repairing the politics or, rather, the politics of repairing the deep--

[Laughter.]

MR. RUBIN: It comes out the same way. Either way, it doesn't matter. This is tough is the point, I suppose.

[Laughter.]

MR. RUBIN: Repairing this fiscal mess, to use a technical term, is exceedingly difficult, but in my judgment, our future absolutely depends on meeting the challenge. Moreover, the longer we wait, the deeper the hole.

Moreover, the claim that this can be made on the spending side alone seems to me simply lacks credibility.

Number one, if you look at what's happened over the last three years, the large increase in discretionary spending and now a prescription drug benefit, with no means to pay for it, it seems to me it suggests the political system simply won't do it, and, secondly, given what the American people want government to do, including defense, Social Security, Medicare and all of the rest, it doesn't make sense to think that that's going to happen.

I think this conference contributes enormously to the public debate by putting forth realistic options that can be debated. I don't think there's any question that what is going to be required is both an increase in revenues and real spending discipline. It is very easy politically to reduce taxes, it is very easy politically to increase spending and let somebody else worry about the consequences down the road. What is hard is to put in place fiscal discipline, but I think it is absolutely critical with respect to economic future.

Thank you.

[Applause.]

MR. HASKINS: Thank you, Bob.

John Porter?

MR. PORTER: Good afternoon. Each of us has seven minutes, and I don't think I can talk as fast as Secretary Rubin talked. I'll do the best I can.

As a former member of Congress and as an appropriator, I am suspect, and particularly in the midst of this large group of economists. But let me tell you, for just a second or two, about my own bona fides. I will probably be remembered as the chairman of the subcommittee for my effort to double funding for the National Institutes of Health over five years. I did that, though, in a growing economy, with surpluses as far as the eye can see, no terrorism and no war.

During the 1980s and 1990s, I was cited by the Concord Coalition and Citizens Against Government Waste repeatedly as the most conservative member of the House or tied for the most conservative or among the most conservative, and I voted to cut and restrain the rate of increase in most every account where I had the opportunity to do so.

I created a group called SEND--Students to End National Deficits. I thought the problem was that serious. I worked to try to solve it.

Bill Frenzel and I--Bill was a member from Minnesota, and he's now a scholar here at Brookings--he and I offered our own budgets for about five years in a row. Our high-water mark was 65 votes out of 435. He was Don Quixote and I was Sancho.

[Laughter.]

MR. PORTER: As chairman of the committee, my first task was to cut \$9 billion out of \$70 billion of discretionary spending in my subcommittee. I did that. It was very difficult to do. The scary thing today is that that discretionary budget, just nine years later, is \$140- or approaching \$140 billion.

The Brookings' effort, it seems to me, is important because it tells us the magnitude of the problem. You can't solve this no matter what philosophy you have without some tax increases or revenue increases. You can't solve the problem without severe spending cuts. That's also a shock. The problem is a serious one, and it must be addressed.

Every member is for balanced budgets. We like to balance them on the other guy's priorities. Members vote to cut defense spending. Other members vote to cut social spending. Very few vote to make both [types of cuts], contribute to the solution to the problem. That's why the three scenarios, in my mind, are important. It tells us the seriousness. It will stimulate discussion and gain interest, and hopefully it will stimulate debate and get some action on a very, very serious problem for our country.

The first step it seems to me is to get critical mass around admitting that we have a serious deficit problem. The party out of power is always concerned. In my first 15 years, we, as Republicans, harped incessantly on the deficits that the Democrats were, of course, creating. Now that Republicans are in power, deficits don't seem so important to us any more. I think we are in denial. I suspect we will be in denial until after the election. The important question is what will be done in early 2005 to come to grips with this serious problem for America.

When Congress and the White House are in control of the same party, and that's likely to be true for a long time to come, Congress is unlikely to lead on the deficit issue. Yes, Congress can raise the issue, can put pressure on the issue, but the president must lead. The president must lead.

Unfortunately, we're going to hear from the president a week from today telling us that we should go to the moon with the new space station and to Mars with a manned exploration, costing some \$500 billion. That money, I understand, some of it is going to be--the first year--is going to be in the budget. It's a message to the American people that we can afford anything, anything. I think it's likely to go away after the election, but it is the wrong message to send that we can afford anything. We definitely cannot.

Also, we're going to hear the message, and we've heard it before, to make the tax cuts permanent. I have to tell you I represented one of the most affluent districts in America, and as I went through my district asking about tax cuts, people would say to me, "I don't need my taxes cut. We need to solve the problems of this country. Don't talk about a tax cut." If I were still there, I would have voted, no, on the tax cuts. I think both messages may be, from the White House, may be good politics, but I don't think, frankly, they are good policy.

It's difficult to get the public to focus on deficits and the debt. Unless the public feels that it affects them directly and personally, they don't focus on it. And the party in power always, whether it's Republicans or Democrats, wants to insulate people from feeling it personally and directly.

In addition, we've had large deficits, large surpluses, large deficits again. People suspect the projections. And Republicans, we do think our policies will bring about extraordinary economic growth and that the problem will dissolve, and I certainly hope that we are right. But, as a fiscal conservative, frankly, I wish that conservatives would act conservative, assume the worst and bring about some real change to address this serious problem.

The book and Brookings' effort on process, I think is a very important chapter, and I would commend that one to you. The budget process, in my mind, is a farce. Members of Congress vote for a budget that restrains spending and then refuse to vote for the bills that make that budget stick. The only way to make the budget stick is for Republicans and Democrats, together, to agree on an overall spending number, to agree on allocations and to shape the bills in a bipartisan manner. Anything less will never get you into balance, in my judgment, and we need to get back to a serious measure of bipartisanship in addressing this problem for our country.

The president, we can say, can use his veto. The difficulty is that every president wants something from the Congress, and you need a president, if you're going to work it only that way, that wants only one thing from the Congress, and that is balanced budgets. I've never seen a president that wanted just that one thing.

Bill Frenzel and I proposed to freeze spending by function. That would mean by appropriations subcommittee allocations--not to freeze programs, but to choose priorities within an allocation, and that of course is the very job that appropriators have. Some years, we proposed a hard freeze, other years a soft freeze. What the message was is restrain the rate of increase, choose priorities. That's the way to address this problem, and I think it's a way to address it that if we can get the critical mass, it can work to solve this problem.

One final thought I have, and I realize I've run out of time, in my judgment, major reform of any type in this country is virtually impossible. We have

entrenched sophisticated, well-financed, politically savvy lobbies protecting most everything.

And the most important reform of all that can address many of the problems that our country has is campaign finance reform, public financing of campaigns. I didn't used to believe this, but as time went on, I came to believe that the only way to address serious problems, to get serious reform, is to get the public financing of our campaigns. The party in power, whichever party it is, is always against it, but that strikes me as the most important reform of all.

Thank you for listening to me.

[Applause.]

MR. HASKINS: Bob Reischauer.

MR. REISCHAUER: It's always a pleasure to return to Brookings, even if the topic that we're talking about isn't exactly pleasurable. But it's an unusual pleasure to be part of a panel which is characterized by Ron Haskins as "decent."

[Laughter.]

MR. REISCHAUER: And so I must raise [the point] that three decent people can outweigh one indecent participant.

[Laughter.]

MR. REISCHAUER: The nation's fiscal situation has come full circle in three short years, having attained the state of fiscal grace between 1998 and 2001, when we ran surpluses. We're now deep in the slow of despond, despairing that we see nothing but large and growing deficits as far as the eye can see and no apparent way to deal with them.

I think Brookings, in this effort, should be commended because I think this effort will first draw attention to the seriousness of the problem; second, underscore the costs associated with inaction; and, third, present policy makers and the public with three approaches that could solve this problem if we had the political will.

It's tempting for many of us who have lived through the past few decades to look back at the experience from 1982 to 1998 and say, well, we've been here before. We were in deep despair. We thought there was no way out of it. Bob Reischauer was willing to bet you a considerable amount of money that he would never live in an era of unified budget surpluses, let alone on-budget surpluses, and yet we did the impossible somehow. And if we could do it in the past, why can't we do it again?

And for that reason, I thought it might be useful, before this group, just to tick off some of the lessons that we learned during this past 20-year period and reflect on how they might apply to the situation that we face now.

The first of those lessons is that you need a widespread bipartisan consensus that deficits are a problem and a sufficiently serious problem that the pain related to solutions is worth enduring. And it took a long time to develop that consensus in this country, basically, a decade during the 1980s, before we were really convinced that that was the thing to do, and it was a bipartisan feeling.

The real question I have, arising from that experience is, will this substitute for Ross Perot?

[Laughter.]

MR. REISCHAUER: Because one cannot underestimate the role that he played in that effort.

The second lesson that we learned during that period was that process is not a substitute for political will and resolve; that process can reinforce political decisions, but it can't force them. We had an unhappy experience with the Gramm-Rudman-Hollings procedures, and there will be a temptation, over the course of the next couple of years, to turn to a balanced budget amendment or some other process gimmick and say the process will make us do the right thing, but processes can't.

The third lesson from that era is that successful deficit reduction efforts involve multi-year decisions, that you can't do them one year at a time. The immediate will always drive out the long run. The pain and suffering from what is facing us today will always trump the long-run benefits that might arise from deficit reduction.

The fourth lesson that we learned during this period is that the fiscal diet must be a balanced diet. It has to include all food groups. It has to have taxes, it has to have discretionary spending, both defense and nondefense spending, it has to have entitlements, both middle class entitlements and means tested entitlements. And here I applaud the Brookings' three options, all of which include tax cuts, some of which include all of the other food groups.

The fifth lesson that I think we can draw from the experience of the last 20 years is hair shirts don't work. By "hair shirts" I mean budget deficit reduction policies in which we say there will be no increases in spending, there will be no tax cuts. Every one of the multi-year efforts, and in fact every one of the annual OBRA's that we passed during that period, had little bits and pieces of spending increases or tax cuts to appease one group or another. They were more symbolic than substantive, but they helped the bitter pill go down.

The final lesson that we learned from the last 20 years is that it pays to be lucky, and you cannot underestimate the good fortune that we had during the decade of the 1990s. Let me just remind you of how lucky we were.

The evil empire fell apart in 1989, and it fell apart in a benign way, and that allowed us to reduce defense spending by 25 percent or so in real terms. In fact, it compelled us to do that. We were lucky in the sense that health spending, having risen inexorably over the previous 15 years, suddenly slowed down to a crawl in the mid 1990s. We were lucky in the sense that we had the longest sustained economic expansion in American economic history. We were lucky in the sense that stock values, equity values in the United States exploded far more than could be rationalized by the good economic news that we had.

And, finally, we were lucky because in the last half of the 1990s, we had divided government, and with divided government comes gridlock; that had Bill Clinton and the Democrats got what they wanted, we would have had surpluses; had the Republicans gotten what they wanted, we would not have had surpluses. Neither got what they wanted, and the American people got what they deserved, which was a surplus.

[Applause.]

MR. HASKINS: Dan Crippen.

MR. CRIPPEN: I want to, before we're through--before I get through--do a little review of history of where we were, how we got to where we are now and where we might be going. Some of you have seen me do this before or, as Robin Williams says in a parody of Walter Cronkite--my apologies to both--"What it is, what it was, and what it will be."

Before I do that, I want to talk just a minute about baselines because we have avoided that discussion so far, and it's an interesting one I think we can't avoid. Clearly, the authors of this report, and many others, have chosen a baseline that they think to be reasonable, and I'm not here to disagree with their sense of reasonableness, but I will say that when you depart from a baseline of current law such as that CBO is required to use, you are left in a position of having to make judgments about future political outcomes, and I'm not sure how good we are at that, frankly.

As economists making political predictions, I'm not sure we're any better at that than we are at making economic predictions, and our record speaks for itself on that score.

As I told Congressman Porter, my father reminds me very often about what Will Rogers said about economists; namely, you can ask an economist his opinion about almost anything, and he's as likely to be right as the next man.

[Laughter.]

MR. CRIPPEN: All of that is to say I'm not sure what baseline I would choose if I were going to depart from the safe haven of a CBO-like current law baseline. I certainly would agree with some of the observations on AMT and perhaps even on some of the extension of tax cuts, but it's not clear where we end up. There are going to be Medicare policy changes along the way. It's not clear to me they're all going to be on the upside. Indeed, we have had increases in taxes and reductions in spending along the way in the past, in part because of the deficit outlook and, in part, for policy reasons.

So I don't know where we're going to be 10 years from now, and once you leave the current law baseline, I find it hard to say exactly where we're going to be. And maybe that's why, frankly, the current bond markets seem to be relatively sanguine about this outlook. Presumably, they have this information. Your former colleagues at Goldman Sachs certainly have it. And if they don't have this information, I want you, Mr. Secretary, to help me short the market as quickly as possible.

[Laughter.]

MR. CRIPPEN: If we know something they don't know, I want to take advantage of that.

But my guess is they're a little sanguine because they don't expect this outcome either. Why they don't expect this outcome, that is, the outcome we're looking at today, because of more responsible policy or economic growth or other reasons, I don't know, but apparently they don't yet or aren't yet convinced that the outcome we foresee is one that is inevitable.

There are many things that can change between now and the next 10 years, including the economy itself, changes in immigration policy, other things that would change this whole outlook. So I'm not convinced what baseline is correct. I am persuaded that perhaps there are things that are going to happen along the line that we should be cognizant of, but to be precise about that is about as good as being precise about the baseline itself.

With that said, let me do a quick review of history. I think it's important to let us know how we got here and where we might be headed.

This first graph is just a decomposition of CBO's outlook for 1997, which was essentially that deficits are going to go on forever--\$200 billion or greater. What happened then, in order to give us the outlook that actually produced some surpluses, were some legislation we all know about, which is the dark-blue wedges here, but they were relatively modest to the overall change in the outlook.

One would say, however, they're not unrelated to what happened, and I'm sure the secretary would as well, not unrelated to what may have happened to the

economy, but at the same time much of this change in outlook and, indeed, the actual surpluses we experienced, were due to changes in economics and other underlying economic factors.

As Bob said, we were very lucky along the way. Much of the change in the economic outlook helped us produce more revenues and, indeed, that level of economic growth produced even more revenues than we would have expected, in part, because of the stock market and the expansion of the capital gains receipts.

But if we look now at what happened, this outlook--the next slide--where we were predicting surpluses, you can see again the decomposition of where the surpluses went. The bottom line is the current CBO baseline. Again, we can talk about whether that's the right one or not. It probably is going to be somewhat lower, and this quirk over here on the right is assuming that the Bush tax cuts go away.

But, nonetheless, you can see that there are other components to how we got from surpluses to spending that are very--or to deficits that are very important; the economy being the largest one, certainly in the short run. But even over the longer run, the tax cuts are not the single most important thing that has caused a deterioration. Spending, in and of itself, is larger. That's not to say that we should have tax cuts or these should remain, but we need to be mindful I think, as we go forward, how we got from an outlook of surpluses to one of the dire deficits that we're looking at today.

The last slide--and all of you who know me will not be surprised to see this--is simply a look at one possible outcome of what's going to happen in the near future, but beyond the 10-year window the authors are looking at here today, and that is my generation's retirement. We all know the familiar discussion--part of the discussion is in the report, of course--on how much particularly Medicare and Medicaid will grow.

And in this view of the world, no matter where you think the exact number comes out, there are really only a couple of moving parts. Indeed, in this case, it's the increase in health care costs that drive this outlook. Social Security, in and of itself, is not growing even as fast as the economy--on a per capita basis as fast as the economy here. So it's mostly the increase in health care costs.

And given this view of the world, the other variable that's important, of course, if you're looking at fiscal discipline and balanced budget, is the level of taxation. So those are the two pieces that really will adhere a fiscal discipline to this outlook, and it will be obviously very significant tax increases if one looks at those as being the solution.

Indeed, in the report, the authors said that there isn't much one can do with Medicare and not much one should do with Medicaid. And so we're left, I think, in the long run, with a need to talk about what we're going to do for tax policy when my generation retires.

So we definitely need to expand our horizon beyond this 10 years--I would argue to the 25- or 30-year mark. During that time when my generation retires, as many of you know, we'll double the number of recipients from 40 million to 80 million. We can't grow out of the problem, as the authors of the report have said. And I would suggest an important criteria for judging any of these plans or other plans would be what effect does it have on this 25- or 30-year outlook.

There were, in the report, some suggestions for Social Security changes, which would help some, and modest changes in Medicare, but it wouldn't change this spending outlook much at all.

What that leaves you, then, as I said, is I think the level of taxes, and we need to start a debate about that quite soon, about how we're going to pay for the impending retirement of my generation. So the outlook is even worse, in some ways, than what the authors said.

However, I do want to say, as some of my colleagues have, this is a terrific effort, and most of you are too young to remember, it's a continuing effort of Brookings on looking at budget options and priorities. The old version, the old series of, "Setting National Priorities," of Brookings' volumes are still worth reading even today.

And one of my measures of, "Is this a serious effort or is it being taken seriously," is does C-SPAN show up. I've found I've had a very hard time getting C-SPAN to cover budget hearings or budget meetings. And so the fact that they're here I think suggests quite strongly not that only is this a terrific effort, it's one that is being taken quite seriously and will be seen by a lot of people.

Thank you.

[Applause.]

MR. HASKINS: Dan, I'd like to correct one obvious flaw in your comments. From the looks of this audience, there are plenty of people here who are old enough to remember things that even happened in the '50s, so--

MR. CRIPPEN: Only on the panel.

MR. HASKINS : No, no, out there too. There's a lot of snow out in that--

[Laughter.]

MR. HASKINS: So we get to ask some questions now, and I'd like to emphasize to the panelists that it's important to try to give short answers so we can ask lots of questions and every panelist can have a chance to answer the questions.

The first and obvious question is what's the big deal? The thesis of this project is that we are in a crisis and that if we don't do something, there will be one or more of five consequences: slower growth, increased borrowing costs, indebtedness to foreigners, increased interest payments in the federal budget, and passing the bill to our kids.

So, panelists, are these real threats? And when would you anticipate they will begin to occur?

Why don't we start with you, Bob, because you have a microphone. In Washington, it's always good to have a microphone.

MR. RUBIN: Well, it depends what you say.

[Laughter.]

MR. HASKINS: I was fully confident you would know what to say.

MR. REISCHAUER: Ask his successor at Treasury if that's true.

MR. RUBIN: My successor was Larry Summers. I think my successor would be fine.

[Laughter.]

MR. HASKINS: It applies to him too.

MR. RUBIN: My successor is in good shape. We're getting to a different subject.

MR. RUBIN: On the question you asked, no, look, I think all of these are serious problems, and I think the real problem is that all of us can come together, and we can have an unholy mess potentially, and I think all of us have addressed that in different ways, and I think that the time to address it is now.

As to why the markets don't reflect it, I've lived with markets all my life. Markets have a way of focusing on the here and now. I spend tons of time with people right now involved in all kinds of trading activities. And if you ask them are they concerned about it, they'll say, yes. If you ask them are they factoring into their current judgments about their activities in bonds, and stocks, and the rest, and the answer is pretty much, no.

MR. HASKINS: But when would you anticipate--there are a whole range of consequences--

MR. RUBIN: Oh, when it will happen?

MR. HASKINS: Yes, is it going to be tomorrow? Is it going to be--

MR. RUBIN: Oh, I think it'll happen when it occurs.

[Laughter.]

MR. HASKINS: You've been in Washington before, huh?

MR. REISCHAUER: If not before.

[Laughter.]

MR. RUBIN: No, I don't think before. I think actually when it occurs.

No, I don't know. I don't think there's any way to predict when it will happen. Look, in the '80s, people were worried about this for a long time, and I think realistically worried, and we didn't start to have a real slow-down until '89, as you remember. And if you look at what happened with interest rates, the economy slowed down, interest rates didn't come down the way you would have expected, and it all became a very difficult situation, but it took quite a while for it to evolve.

MR. HASKINS: Well, as the other panelists answer this, I mean, I think several people have commented, and it's obvious, that part of the goal of this project is to bring the importance of this issue to people's attention. And if we say to the American people, "Oh, my gosh, there are five horrible consequences, and they will occur someday," I mean, that's not exactly a rousing call. So it is a crucial issue, even though we can't predict, with any exactitude. I mean, I'll--Bob?

MR. REISCHAUER: We'll get worried about this as a people when there appears to be adverse economic developments, whether those adverse economic developments are, in any real sense, associated with the build-up of debt and the size of deficits. And that's what happened during the 1980s and the 1990s. It wasn't necessarily that, in an economic seminar, that somebody would tie, you know, slow productivity growth, whatever our malaise was to the fiscal situation, but in the popular mind, that occurred, and it will happen again, whether it's the collapse of the dollar or whatever.

MR. CRIPPEN: And as you said, Bob, that without Ross Perot, it's not clear what would have happened and when. And so, to the extent this becomes a political phenomena that pushes the Congress and the president into doing something, it will depend upon the development of it as a political issue, much more potently than I think it has so far.

MR. RUBIN: Yes, I do think, Dan, at some point you are highly likely--but it may be well off in time or it may not be--highly likely to see exceedingly sharp

impacts on interest rates, and I think, Bob, people will tie that, at least my guess will be, both substantively and politically tie that to fiscal conditions.

MR. HASKINS: We have a number of people on this panel who have had the opportunity to advise presidents or to advise senior members of Congress. Next week is a State of the Union address. Imagine that you were in a position to advise the president or advise senior of members of Congress. I assume that everybody, possibly, except Dan, would say we are, in fact, either in a crisis or about to be in a crisis, and here is what you should do now.

What is it that you would tell them to do?

MR. CRIPPEN : I mean, frankly, it's not that I don't think we might be--I think we're in a long-term crisis. It's not today or tomorrow perhaps, especially given the state of the economy, but it's something that we are going to have to address soon. And this kind of effort, while it's aimed at looking at the 10-year budget, is critically important to bringing us one step closer to at least getting into the next decade and beginning to deal with that issue.

Whether or not you want to stay employed by this president is another question, but--

[Laughter.]

MR. CRIPPEN: But, for me, it is that issue that's most important, and it's going to take, as Congressman Porter said, presidential leadership to do anything about whether it's the short term or the long term. And, for me, that would mean probably Medicare reform and, secondarily, maybe Social Security reform, but more importantly Medicare, health care reform of some kind, and in an election year, is that what the president--would you advise a president to do that is an open question.

MR. HASKINS: And what about tax cuts?

MR. CRIPPEN: I wouldn't call for more tax cuts, but that's what I mean. I mean, as I said, I'm not employed there, and probably wouldn't be, but--

MR. HASKINS: No, you won't now, for sure.

[Laughter.]

MR. PORTER: Let me comment on it.

MR. HASKINS: Yes, go ahead.

MR. PORTER: I think, if the president would simply put a good, strong paragraph in a speech that will cover practically everything and say this is a serious

problem that his administration is going to address and will have specific proposals when they work it through, just something to put a mark on the need to address this, I don't sit here and expect him to put it in a major place in an election year, and neither does anybody else. But recognizing that it's a serious problem and that the administration intends to do important things about it, and is reviewing it and going to address it in the near future, I think would do a lot to get people focused on the seriousness of the problem to the American people.

MR. RUBIN: Could I ask you a question, John? But how would he reconcile that, with advocating that the tax cuts be made permanent?

MR. PORTER: Well, I just said I think he ought to not make the tax cuts permanent, and I think we ought to not plan to go to the moon or Mars with manned exploration. So I don't think you can reconcile it.

MR. HASKINS: I wish I weren't sitting next to John Porter to point this out, but it's pretty obvious that the most important thing that's happened so far today is that a very senior member of Congress specifically said that we should not extend the tax cuts. So that's quite a remarkable thing.

MR. PORTER: Well, I'm no longer in office, so it's an easy thing for me to say.

[Laughter.]

MR. HASKINS: Well, no, but you still have friends in the House--

MR. REISCHAUER I don't think you'll be re-elected.

[Laughter.]

MR. HASKINS: Here is what I have heard repeatedly. Some of the rest of you may have heard this same thing.

"Relax. This is not that big a deal. First of all, we're going to trim spending. We're going to control the growth of spending. We're going to slow it down, and then we're going to grow out of this deficit." Is that a realistic prescription?

MR. CRIPPEN: No. I mean, as the authors quite aptly point out in the report, you can't grow out of the deficit, and you're not going to restrain, politically or otherwise, spending.

The issue, again, and certainly in the long run, is not domestic discretionary spending, which is what most people are talking about. It is Medicare, Medicaid, Social Security, and the level of taxation. And once you get past those discussions, there isn't a lot left, in this long-term outlook at least, to argue about.

MR. PORTER: I thought--

MR. HASKINS: Republicans are dominating. This is what we planned.

[Laughter.]

MR. PORTER: Dan, I thought that the report had said that over the 10-year period, if growth rates were 4 percent per year for the entire 10-year term that the problem would go away, although not the long-term problem, and I think every American hopes that the growth rate is 5 percent.

The difficulty is, is that the historical rate is at 3 percent, and not too many--and I'm certainly not an economist--but not too many economists think that it's likely that we will have an increase to 4 percent over that long a period of time. I'd like to know what these economists think about the possibility of our doing that.

MR. HASKINS: That's a good point. So the claim is that if we could grow at 4 percent a year for a decade, everything would be fine. Is that realistic? That's his question.

MR. REISCHAUER: Are you asking me--oh, is it realistic?

MR. HASKINS: Yes.

MR. REISCHAUER: No. I mean, is it possible? Yes. Should we predicate our budget policy on that assumption? No. As the book points out, very cogently, it's easier to go in one direction than the other if you're wrong. If it turns out that growth is faster than projected, the deficit is coming down faster than expected because of the cuts that are in place and the rapid economic growth, we certainly can find our way to stopping the cuts or stopping the tax increases. But if we get halfway through the next decade and we find that growth is really 2 percent, then, we're really in trouble.

MR. RUBIN: I think there's another problem as well, which it seemed to me that the general thrust here was that having these very large deficits, instead of promoting growth, is most likely to undermine growth.

So whatever you might have thought the projected rate of growth would be, and I think Goldman Sachs projected a 10-year deficit of \$5.5 trillion, and I think they were using growth of 3.1 percent--I've forgotten--but something like that. But it seems to me that the very deficits that you're trying to deal with are themselves undermining of the growth that some people are claiming will solve the problem.

MR. HASKINS: Moderators are not supposed to participate, but I think, as a matter of logic, it would be good to point out that the consequences of being wrong

and having solved the problem too much, as opposed to the consequences of being wrong and not having addressed the problem are quite radically different. So that's another thing I think people would have to consider in making a decision.

Let me ask one more question of the panel before we turn it over to the audience, and let me be bipartisan about this.

Some of us remember, in 1995, 1996, Republicans shut down the government twice over a budget deficit, and they were insisting that the president come up with a 7-year plan that would balance the budget using CBO scoring, and when he didn't meet those specifications, Republicans closed the government. And if some of you might go back and read the rhetoric at that time, the future of the nation and our children was at stake. This was the most important thing in several decades. We had to balance the budget.

And now here we are again, in 2004, in a situation very similar to the situation in the mid 1990s, except that we're much closer to the problem that Dan has emphasized, which is the retirement of the baby boomers, and where is the outrage? Where's the concern? What happened? How can you explain this? I am truly perplexed.

[Laughter.]

MR. PORTER: I'd sort of like to leave him perplexed.

[Laughter.]

MR. PORTER: I think one thing that I mentioned in my remarks is true, and that is that we have had, up until the last few years, surpluses for a while, and we had deficits for a long, long while prior to that time that never did get brought under final control. So I think it's a reasonably recent phenomenon to have deficits that we've had for the last couple years, and we're again dealing with projections for the next 10 years, and as I said before, I think people, given the history of things, don't really believe necessarily the projections, and there needs to be a longer historical context before you can get that critical mass.

MR. REISCHAUER: To what John has said, I would add two other factors.

First and foremost, probably, is that there have been a few diverting issues--war in Afghanistan and Iraq, 9/11--and a slowdown in the economy, combined with a collapse of equity markets. So people have been focusing on that.

In addition to that, as opposed to the mid 1990s, certain dimensions of our economy for the employed population have been performing very, very well. It's cheaper to buy a house, I mean, mortgage interest rates are at an all-time low, and have

been for a long period, and inflation has been very much under control, and so it's very hard to translate this abstract notion of the government is spending too much beyond its means into what are some adverse consequences for me sitting at my kitchen table, except if I'm unemployed, and if I'm unemployed, you're saying to yourself, more tax cuts, more government spending, do something to stimulate the economy in the old-fashioned way.

MR. HASKINS: Okay. Audience participation. Let me remind you that everybody else in this room, except whoever asks the question, would rather hear from the panelists than from you. So please ask short questions.

MR. CRIPPEN: Don't be so sure.

[Laughter.]

MR. HASKINS: Who has a question? In the back there. They'll bring you a microphone. Tell us your name and ask the question.

QUESTION: Lisa August with OMB.

What role do you think the Federal Reserve should play; that is, should it be active or neutral?

MR. HASKINS : Dan? Somebody?

[Laughter.]

MR. CRIPPEN: Well, I'm not quite sure what you mean by active. I think the Federal Reserve is going to play an accommodating role here with the economy, at least if you believe the public statements and those who tea-leaf Greenspan better than I do, they're certainly going to be neutral to promoting economic growth and lower interest rates for the next year or so.

I think your question was normative, what should they do, and in the long run, the best thing they could do is whatever it takes to keep inflation low, but, I mean, that's kind of a naive statement. So I'm not quite sure how to answer your question.

MR. HASKINS: Does anybody else want to add anything to that?

[No response.]

MR. HASKINS : Next question. Follow her example. That was nice and short. Yes, right behind you.

QUESTION: Hi. Bud Newman with BNA's Daily Tax Report.

For the purpose of the question, can we assume, just for a moment, that President Bush is re-elected and Republicans control Congress after the next election. Do any of you on the panel believe that under that scenario that President Bush would ever put forward or the Republican Congress would ever pass a deficit reduction package that included revenues, tax increases of the kind that were described in the report? Do you think that will ever happen?

MR. HASKINS: Excellent question.

Dan, especially, and John Porter. John, you can go first.

MR. PORTER: I think, if the problem is perceived as severe, as we think it is, and if the situation in Iraq improves, and the terrorism threat recedes somewhat, I think that the president might well propose some way of addressing the problem.

I think elections have ways of really distorting what people believe in their hearts about addressing problems, and when the election goes away, I think there's a real chance to address things in a very real way. So, yeah, I'm hopeful that that might happen if we find ourselves in that situation.

MR. CRIPPEN: I guess I'd say roughly the same thing. I mean, remember--and, Bud, I'm sure you do--that Reagan, after '81, subsequently endorsed or otherwise acquiesced to something like 11 tax increases, and most of them in trade for other things he wanted--spending reduction and other policies. So, if Reagan can do it, maybe Bush could, too, and particularly if there's something else that's important to him involved, whether it's entitlement reform or something else that I'd like him to address. So I think it's possible that he would.

MR. REISCHAUER: But if the dollar collapsed and interest rates spiked, there would be a "eureka moment" in the White House.

MR. PORTER: Well, and one thing is very much different, and that is that the Congress and the president, as you assumed, would remain in control. And when you're in control of the entire government, you become the responsible party. And if you don't address problems that affect people, you're going to pay the political price for it, and I think that whatever party is in control doesn't want that to happen.

MR. HASKINS: Bob, do you want to add anything to this?

MR. RUBIN: They don't consult me, so I don't--

[Laughter.]

MR. HASKINS: They soon will, though, Bob.

MR. RUBIN: I think that's probably unlikely, but in any event--

MR. HASKINS: One more question from the audience. In the back.

QUESTION: Hi. Robert Sherretta with International Investor.

Particularly for Mr. Rubin, although any of you. You mentioned that Wall Street has a short-term focus. We spoke to Mr. Jagadeesh Gokhale about six months ago.

MR. RUBIN: To who?

QUESTION: Jagadeesh Gokhale. He's a co-author of "Fiscal and Generational Imbalances." He has a report out on that, to that effect. His argument is that in about 2008 a flash point occurs in terms of the surpluses turning into deficits in Treasury obligations. Do you think foreign investment will react prior to that kind of flash point?

MR. RUBIN: I think it's impossible to know when markets are going to react. I think one of the problems is that if markets don't react for a while or at least don't react in a very major way, that people may be lulled or there may be a tendency to get lulled into some kind of complacency which I think, to some extent, we have now on these issues.

As I said in my remarks, I think the probability of these kinds of effects happening is exceedingly high. The timing I think is simply unpredictable. Markets do tend to have a short-term focus, and it may be that it will happen in the nearer term, but it may be it will take quite some time.

But the fact that it takes quite some time doesn't mean any the less that it's likely to happen, and I think it has the disadvantage of carrying this on longer, making the hole deeper, and lulling us into a kind of complacency, rather than causing us, as Bob Reischauer suggested, to actually deal with it. But I don't think there's any way to predict when these things are going to happen.

MR. HASKINS: Does anybody want to add to that?

[No response.]

MR. HASKINS: Well, join me in thanking this panel and thank the audience for great questions.

[Applause.]