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PANEL TWO: REACTIONS FROM THE CAMPAIGNS

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PANEL TWO: REACTIONS FROM THE CAMPAIGNS

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Question and Answer Session

THIS IS AN UNCORRECTED TRANSCRIPT.

PANEL II: REACTIONS FROM THE CAMPAIGNS

MR. HUNT: After that fascinating first session, we now can find out what the candidates and campaigns are going to do about the picture that has just been presented.

On our second panel today, we have Jim Capretta, who is a senior advisor to the Bush campaign and for almost three and a half years, till last month, was the associate director for human resources in the Office of Management and Budget; and Jason Furman, who was special assistant for economic policy to President Clinton, was the policy director for the Wes Clark campaign--you delivered Oklahoma, right, Jason?--and now is director of economic policy for the Kerry campaign.

Questioning them afterwards and contributing to the dialogue will be Ron Haskins, whom we've already referred to. He's one of Washington's great experts on fiscal and welfare matters and other domestic issues, former top Ways and Means Committee staffer, senior fellow here at Brookings, and senior consultant to the Annie E. Casey Foundation; and Tom Mann, who is a senior fellow for governance studies at Brookings, a former executive director of the American Political Science Association, a renowned expert on Congress, and the most quoted academic on that subject who is not named Ornstein.

[Laughter.]

MR. CAPRETTA: Well, thank you very much. It's a pleasure to be here. I was very interested in the previous panel. I agreed with some of what was said, and some that I didn't agree with, and I'll get into that a little bit here.

I want to go back and review a little bit about some principles that underlie the president's budget. I want to talk a little bit about where it's led us. I want to take a closer look at Senator Kerry's proposals. And I want to touch on, a little bit, some of the comments about the long term and concerns about long-term entitlement spending, which is a very valid concern.

First, the president's priorities. Certainly since September 11th, in the last three budgets, he's articulated the same three top priorities and I think his budget numbers reflect those priorities very clearly. He's made an absolute commitment to win the global war on terror, he's increasing homeland security funding at a very rapid clip, and he's unrelenting in his pursuit of job growth.

So in this budget, the 2005 budget, defense spending is up 7 percent, homeland security spending is up 10 percent, and tax relief that we believe has been so critical to the economy coming back strong is extended permanently.

Outside of these priorities, the president shows restraint. Non-defense, non-homeland spending is held to .5 percent increase, and going back through the first four years of this president, the rate of growth should be compared to the last year of the Clinton administration, when it increased to 15 percent. So I take a little bit of exception to what Belle said, that discretionary spending doesn't matter. It does matter when the difference is that big. In the first year of this president it was reduced to 6, then to 5, then to 4, and of course in this year's budget, it's down to below 1 percent. Outside of that, there's also a new requirement to offset any mandatory spending increases, which I'll talk about a little bit more later.

So where has this led us? The economy is doing very well. Economic growth over the last 12 months is the fastest in nearly 20 years. We've produced 1.4 million new jobs in the last nine months, including 250,000 in May and about 350,000 in April and March. And 30 percent of all U.S. employers now expect to hire in the third quarter of this year. So the president's laser-like focus on this issue--which has been the issue in the economy--is producing results. I would also comment that real per capita income in this administration is up $1,900 in real terms after tax since January 2001.

Now, taking a closer look at Senator Kerry's budget plans, I want to go through this somewhat carefully, because I think there was a bit of a premise in the previous panel that it's a wash. I don't think it is, by quite a bit.

The president has put forward a budget that anyone can read. It's account-by-account, painful for me to put together, lots of controversy. But it's there for everyone to see. I don't think Senator Kerry quite yet has a budget plan, although it may be coming more into focus as people take a closer look.

First, I don't think Senator Kerry fully accounts for all the promises that have been made throughout his campaign. We at the campaign--through independent sources, not calculations done there--tried to assess essentially all the things that were promised, and they add up to way, way more than what they're accounting for in their budget numbers. Now, they may be disavowing some of these promises now, but I can tell you from experience at OMB, the constituencies that were promised something before will remember. And there's going to be a lot of pressure on all of those promises that have been made that are not yet accounted for in his budget. We did a simple calculation--it adds up to $1.9 trillion over 10 years above President Bush's budget. That's a lot of money.

Second, there is no independent assessment of the health care plan. Now, I take no exception in the objectivity of Dr. Thorpe, but that's not the same thing as a CBO estimate. And I believe these entitlements in the Kerry health care plan have the potential to be much, much more expensive than Dr. Thorpe has assessed. And I think getting CBO to take a look at this will be critical to understanding whether or not this is affordable or not.

Third, Senator Kerry in his numbers claims about a trillion dollars in tax increases for his new spending. But Treasury will not score nearly that much for these taxes. For instance, on foreign income deferral, the campaign believes it can raise about $120 billion over 10 years from this provision. Other experts think that $60 billion would be at the very outer limit. So all in all, I think when Treasury takes a look at these proposals with the enforcement mechanisms, there's probably about a $300 billion hole there.

Fourth, Senator Kerry's spending reduction proposals I don't think are serious. They have the feel of sort of a--for those of us in budgeting, of sort of round up the usual suspects. There's a corporate welfare commission, where in their numbers they're claiming about $300 billion from this commission. You know, if there were $300 billion in corporate welfare that could be found and used to pay for spending, it probably would have been taken by now. By the time you set up a commission, have them study, have them report, have them act on legislation, you're half-way through the term of the next president, if not all the way through. So I have very little confidence that a commission like that is going to produce much, if any, legislative, politically realistic savings.

Then there is savings assumed in the health care plan. There's about $200 billion in savings from three items--disease management, preventive services, and health IT. I think one of the previous panelists commented on these a bit, worthy--I think Jack Meyer mentioned them--the worthy, good ideas, well under way in this administration, all being pursued with great vigor. They're complicated. But I can tell you, CBO will not give anywhere near that much savings. Neither will HHS. It's too untested and too uncertain. And very, very difficult to capture.

Then there are these other ideas: cutting the travel budget $10 billion, saving on electricity bills $14 billion, and $50 billion by cutting unspecified government contracting work by 100,000. On this one, the question is what work do we want to stop doing if you're going to get rid of 100,000 contractors? My understanding from others is that a lot of the contractors are doing manufacturing work for the government, and there could be a lot of job losses from 100,000 contractors indiscriminately being cut off. The question is do we really want to do that.

Match these offsets against the massive new entitlements promised by Senator Kerry--reinsurance for all employer health plans, 100 percent of costs of kids on Medicaid--and you have a recipe for something that's not going to add up easily. All in all, the hole in the Kerry fiscal plan is probably about a trillion dollars.

Now, why is this important? I think it's important for one reason, which was--I think in Dr. Thorpe's presentation, he sort of set it up as this is taxing the rich versus spending it--essentially what he said. And I don't think that's the choice. I think it's going to be ballooning deficits from all the promises, or going back to something that Belle alluded to, which is taxing the middle class. And, you know, the previous experience from '92, as Dr. Sawhill commented, was painful, but the previous Democratic president chose to tax the middle class, not extend the tax cut to the middle class. I think that this needs to be examined a lot more carefully.

Now, I want to turn for a minute to the long term. I think a lot of the commentators on the previous panel are rightly concerned about long-term fiscal issues. I am, too. It's a very difficult problem. But I would say that this administration has done a couple of things that I think are very important.

First, we put forward the clearest presentation I think has ever been done about what the situation actually is. And that gets into the situation with Medicare in particular, where, for many, many years, the Part B side of Medicare was always described as a solvent fund because of its general revenue contributions. And, at least in this administration, many of the documents that were put out tried to make it clear to the policy community that, no, that money is not there in a magic sense, but it's going to need to be paid for either through other spending reductions, taxes, or borrowing.

Secondly, I think it needs to be restated that the president has shown great leadership on Social Security. It is not, I'll admit, as big of a fiscal problem over the long term as Medicare, but it is still very, very large. And the president has made it very clear that he is willing and eager to show the leadership that it's necessary to move the system to a much more solvent and secure program.

And the transition costs to personal accounts I think need to be clearly articulated as not the same as spending--that there are transition costs to a social security plan that is essentially pre-funding commitments that are already in the system, and that is not the same as creating a new government program. In fact, when it's all said and done, a good social security plan is going to reduce the debt held by the government over the longer term, not increase it. And that's a very important point.

[Applause.]

MR. FURMAN: Thank you for giving me the opportunity to speak here today.

I just wanted to talk about, really, two main things in this presentation. One is some of the macroeconomic debates that are going on right now with what the state of the economy is--and I see Jonathan Weisman, here in the audience, wrote about that today. And then talk a little bit about what you need to know about John Kerry's fiscal record and fiscal plans. And then some of the questions that I have in terms of George Bush and what his fiscal plans are.

There's been this debate going back and forth for the last several months about what's going on with jobs. And there's no doubt that jobs have been going up more in the last several months than they had in the previous three and a half years, and that's something that we all welcome at the Kerry campaign. It's also, people have talked about pessimism. We're not predicting a double-dip recession. We're not saying the economy is going to get much worse next year. We're not talking down the economy in the same way that, for instance, Dick Cheney did at the end of 2000.

What we are trying to do is engage in a debate. And that debate is centered around a really crucial question, which is whether the president's tax cuts worked to stimulate the economy and get jobs going again. And if your answer to that question is yes, then you should want to support those tax cuts in retrospect and may even want to make those tax cuts permanent and use that type of tool again in the future. Or did the tax cuts not work and did they fail to deliver what was promised--in which case, we'll have to be much more skeptical about assessing them in retrospect and supporting them in the future.

So this debate is not sort of are you blaming everything on the president, or does the president cause every job--of course the president doesn't. The question is did the tax cuts work or did the tax cuts not work. And I think the answer there is that they have dramatically failed to work. We were projecting last year, the Council of Economic Advisors projected 308,000 jobs per month in the year after the tax cuts were passed. We've fallen short of that prediction in 10 out of the last 12 months. We're now in the 30th month of the recovery, and in the last year we've seen 1.4 million jobs. That is the worst period from the 19th to 31st month of a recovery that we've seen in the entire post-war period.

So the fact that you wait long enough and you eventually see some job gains is not a testament to the tax cut working. Previous recoveries, we've actually seen stronger job gains than this; the administration was projecting stronger job gains than this; and I think, based on recent macroeconomic performance, there is no evidence that the tax cuts are working and no evidence that we should be continuing them as a centerpiece of our macroeconomic strategy.

I just want to shift from there to talk a little bit about the fiscal situation. And first, three things that everyone in this room should know about John Kerry and his fiscal plan.

First of all, he has a very strong record on fiscal discipline. He was one of the first Democrats to support Gramm-Rudman-Hollings in the 1980s, at a time when deficit reduction was not a central tenet in the Democratic Party in the way that it has been since Bill Clinton was president. This is a record he built on throughout his time in the Congress, voting in 1993 for Clinton's Deficit Reduction Act--which was a very tough vote at the time and passed by one vote in the Senate--and voting again in 1997 for the Balanced Budget Act.

So that's the first thing you need to know, and I would contrast that to what we do know about President Bush and his record on fiscal discipline--which is the worst fiscal deterioration this country has ever seen. And we know what President Bush's record is, and there's no reason to suspect it will be different going forward.

The second thing you need to know about John Kerry is that he's going to pay for all of his proposals, and we have laid out in detail the principles by which we're going to do that. We have PAYGO rules on both the tax and mandatory spending side. And in that context, repealing tax cuts for families making above $200,000 would raise $860 billion over 10 years. That's an estimate from the Tax Policy Center that Len Burman and his staff did, and that's the number we're relying on. And that would pay for the health care and the education plan.

These are estimates. Our education plan, Len thinks, would cost $50 billion; Belle Sawhill has an $80 billion estimate. But rather than getting caught up in all the numbers, let me just say the fundamental principle is we're going to abide by PAYGO. So when we get into office next year, these are our very best estimates, they're based on independent estimates from people like Ken Thorpe and the Tax Policy Center.

But we're telling you what we're going to do next year, and our proposals will abide by PAYGO.

Similarly, on the discretionary side, as Senator Kerry has been releasing his proposals over the course of the campaign, he has again been very explicit in saying how he'll pay for them. So for instance, in the service plan he released a few months ago, he talked about student loan reforms to reduce interest subsidies for banks. This is something that CBO scores; we're relying on their number. It's something we've gotten a lot of complaints, including complaints from some of our fund-raisers, for doing, but we believe it's important to show how it is that we're paying for our proposals. Similarly, on energy, environment; tomorrow we're releasing a tech plan. All of these, we're explaining how we're paying for them.

Just, you know, going beyond the numbers, though, this is just a fundamental change in philosophy. President Bush has been in office for four years and never once used the words "pay for his proposal," has never once said what his offsets are. It's just not part of his vocabulary. It's not a question of whether his numbers add up or don't add up. It's a question of whether he even abides by or agrees that that should be a principle that we live by. The tax cuts weren't paid for, the Farm Bill wasn't paid for, the Medicare wasn't paid for. If you add it all up, it's over $6 trillion. Going forward, you even take small initiatives like the $80 billion health plan; there's no statement, as one of the panelists said, about how that will be paid for. It's just not part of his vocabulary.

The third thing I just wanted to mention is that Senator Kerry has really done something. Which is to say, it's not just that "everything has to be paid for," but his own priorities, too, and he's willing to sacrifice his own priorities if he can't figure out a way to fit them in the context of a responsible, reliable budget. And back in March, when he came up with his proposals in the primaries, since then the deficit's gotten a trillion dollars worse. He said he would like to have universal pre-school, but he can't afford it. National service is something that is extremely dear to him. He said he couldn't afford it, and scaled back what his plans were there. And scaled back in some other areas, too. This is somebody who, when times change, shows the courage to alter a course as necessary to fit in with those changing times.

George Bush supported a tax cut when the economy was good in 2000. As the economy turned sour in 2001, he supported the same tax cut and, as the deficits got bigger, continued to support bigger and bigger tax cuts, and has never shown the courage to sacrifice his own priorities or pay for his own proposals.

With those three things that you need to know about John Kerry--that he has a record on fiscal discipline, will pay for all of his proposals, and is willing to sacrifice his own priorities--I just wanted to talk, you know, a little bit about some of the unanswered questions we have about the president.

The first question is just will there be more tax cuts in a second term. And we don't know the answer to that question. The president has not ruled that out. He hasn't told us what his principles are in terms of tax cuts, because he said any of the PAYGO rules should only apply on the spending side, but has exempted the tax side.

The House passed middle-class tax cuts that go substantially, as Len was saying, beyond the ones that were passed in 2001 and 2003, and the White House hasn't objected. The House jobs bill is also not fully paid for, and last week Secretary Snow issued a statement that did not explicitly state that the president would only sign a jobs bill that was fully paid for. In fact, he said--I can't remember the exact language he used, but it was something to the effect of we should try to pay for a lot of it. So in the way they're dealing with congressional legislation this year and in exempting tax cuts from PAYGO going forward, we just don't know the answer to whether there will be more tax cuts if the president is reelected.

I think we do know the answer of, if there are more tax cuts, what type they'll be. And they'll generally be ones that move in the direction he's moved throughout his term, of shifting taxes away from wealth and towards work in a manner that's regressive, and [inaudible] a value added tax.

The second question that we don't know the answer to is what will happen in a second term. Will there be the spending cuts that the president has promised, or will we miss the deficit projections that the president has promised? These spending cuts are really draconian. Homeland security is a priority of the president. In the 2006 budget, homeland security is cut, in nominal terms, from 2005 in the budget tables that Jim Capretta and his colleagues at OMB produced. Veterans is cut by $910 million. Education is cut by $1.5 billion. These are all nominal cuts, you know, not counting inflation, not counting what's needed to fully fund these programs in 2006.

That's one possibility that might happen. Or what we might end up doing is getting to FY 2006 not doing those cuts, in which case we're going to end up missing the projections by a wide margin. Just to conclude that one point, you know, if you look overall for non-defense discretionary spending in the president's budget, it's $300 billion below inflation. So either that's going to happen, in which case we're going to have these large cuts; or he's going to miss his projections by about $300 billion.

In contrast, Senator Kerry has actually budgeted $200 billion over inflation for his education plan. Everything else grows with inflation, which actually is a more credible, responsible projection of discretionary spending than we even did in the Clinton administration, where generally the budgets grew with inflation or even were cut below inflation in the out years in terms of responsibly budgeting for it.

So I just want to conclude by saying that John Kerry is really somebody who will change the fiscal vocabulary in Washington while emphasizing priorities like health care and education that, hopefully, we can get to in some of the questions. And I think that's something that is badly needed.

[Applause.]

MR. HUNT: Ron?

MR. HASKINS: Our format here is I'm going to ask you a couple of questions and then Tom is going to ask Jim a couple of questions, and then we're going to have more of a free-for-all.

My first question is, on January 8, 2002, President Bush signed the No Child Left Behind Act. Would a President Kerry have signed the act?

MR. FURMAN: Senator Kerry voted for it, yeah, so he certainly would have signed it.

MR. HASKINS: What is Kerry's main criticism of the No Child Left Behind, the way it's been implemented?

MR. FURMAN: The main criticism he has is that it imposed a set of requirements and responsibilities on states--for instance, testing, which costs billions of dollars a year for states to do--without giving them the additional resources that were initially promised in the authorization levels for that bill. So, for instance, his Great Teacher in Every Classroom is a combination of requiring more from teachers in terms of certification when you first start teaching and in terms of making it easier to dismiss teachers that don't perform well, at the same time that it provides additional resources for an additional $5,000 for teachers in--

MR. HASKINS: According to the budget figures, in nominal dollars spending on elementary and secondary education increased by about 80 percent and inflation-adjusted dollars 65, or between 65 and 70. So a President Kerry would have increased education spending more than that?

MR. FURMAN: Between 65 and 70 what?

MR. HASKINS: Percent.

MR. FURMAN: Oh, in--

MR. HASKINS: Inflation-adjusted dollars, between 2000 and 2005.

MR. FURMAN: Yes, he would have. And he is--again, some of this is a question of priorities. He puts less of a priority on additional tax cuts for people above $200,000 and more of a priority on health care and education, and believes we do need to ask more of our schools, but we need to give them the tools to ensure that they can do more.

MR. HASKINS: Another area, Social Security and Medicare. The Republican view has been that we have to change the structure of these programs in order to realize long-term economies and to reduce spending and to escape from certain fiscal disaster that those programs are going to cause. I assume you agree that that's the case, if we don't do something there will be a disastrous future.

MR. FURMAN: There's no question that we face challenges in Social Security and Medicare. In Social Security in particular, those challenges are manageable if we can act early and address them.

MR. HASKINS: During the election will Senator Kerry, or if he were elected will President Kerry, put specific proposals on the table, the kind of reforms that we need that would change the nature of Social Security and of Medicare so they can be financed in a way without wrecking the whole budget? And if he's not going to do this during the campaign, why not?

MR. FURMAN: He has put out a set of principles to address Social Security and Medicare, the principles that will guide his approach. One is that we need to restore fiscal responsibility. He sees both Social Security and Medicare as part of a broader fiscal challenge. And this is a broader fiscal challenge that we can address partially on the revenue side, with taxes, and partially on the discretionary-spending side, with restraint. And he wants to put our fiscal house back in order and start to make that very first step as a down payment towards addressing this.

The second thing he's said is that the only way we've ever successfully reformed these proposals is by building a bipartisan consensus and working together with both parties to address this challenge. I think if you look at President Bush and Medicare debate and the way Social Security in this commission has played out, he's not somebody who is going to be able to address this issue on a bipartisan basis in his second term. Senator Kerry worked with both parties on Gramm-Rudman-Hollings, worked with both parties in 1997, and he'll be able to do it again. But I do think if history is any guide, that's the way we're going to get something done, not by proposing a detailed plan in the context of an election year.

MR. HASKINS: My last question: Granting your point that it is good and even unusual for a presidential candidate to talk about how he's going to finance his proposals as well as just to make proposals. But nonetheless, according to Capretta's figures, the numbers that you are using, that there could be as much as a trillion-dollar hole. Now, allowing that there could be differences in estimating techniques and all that, a trillion dollars is a lot of money. What is your response to the trillion-dollar hole in your estimate?

MR. FURMAN: I mean, well, let's first of all talk about some of those estimating differences. I mean, Jim talked about not relying on Treasury numbers and then pivoted from there to the deferral numbers that we're using. The $120 billion that we're using for our deferral proposal is actually based on the Treasury figure. The Joint Committee on Taxation has a different model. They estimate that at $60 billion. It's a very technical question, but in that particular case, for example, we're relying on Treasury numbers.

The rest of that trillion dollars, it's something that the RNC put up on their Web site. There are all sorts of proposals, like our education trust fund is $200 billion, has a lot of components to it, like $30 billion for teachers--they'll count that twice. They put things like high-speed rail--can't find it anywhere on our Web site, anywhere on the campaign trail Senator Kerry's talked about it. Put an awful lot of things he doesn't support, or higher cost estimates for things he does, and double-count things. So I don't take that number very seriously.

What you do need to know, though, is that everything--we're just going to pay for every proposal. And if we get into office and Treasury says, you know, deferral is $100 billion or 120 or 140, we'll adjust it so that it adds up. But those are our best estimates at this point.

MR. HASKINS: Tom?

MR. MANN: Jim, Bruce reminded us this morning that in 1982 Ronald Reagan signed the largest tax increase in many a year. He subsequently signed additional tax increases, arguing that the ballooning deficits required some move to enhance federal revenues along with all of the efforts to try to restrain federal expenditures. The first President Bush signed a budget agreement that included raising the marginal rates on the highest 1.5 percent of households. Bill Clinton did the same thing, very similar to the Bush 41 tax cut. Both also had some spending restraints through the budget rules, the BEA, and the PAYGO. During that period we had federal revenues of 18.5 percent to as high as 21 percent of GDP. 19 million new jobs were created in the 1980s, 22 million new jobs in the 1990s. There's little evidence that those tax rates were a great restraint on economic growth, on capital formation and investment.

Now, under President Bush 43, our revenues are down to 16 percent of GDP, and we have huge budget deficits that will get larger over time as the boomers retire. What is the economic basis for saying that we need these lower tax rates in order to grow the economy?

MR. CAPRETTA: Well, there's a lot in that question, so I'm going to back up a bit. First, the reason why revenues were so down as they were in '02 and '03 and '04 is because of the slow growth in the economy. I mean, I think the estimates are that half of the increase in the deficit occurred in those years, relative to a previously very inflated baseline, was associated with wrong assumptions about economic growth, and a war that was prosecuted on terrorists. So we are where we are for factors that really were largely outside of anyone's control.

Secondly, as I articulated at the beginning of my talk, the president is very focused on job and economic growth. And the economy has struggled, but now it's producing jobs at a good clip. And my--you know, the president has made it very clear that that's his priority. And I don't think he believes that a tax increase or contemplating a tax increase at this time is the right thing to do just as the economy is producing the jobs that are going to help so many Americans.

Now, in terms of fiscal policy, the president has already articulated a commitment to cut the deficit in half. That is not going to be easy. It's going to require a lot of spending restraint. And our budget ends up to cutting the deficit in half. Now, that will require a lot of decisions along the way to ensure it's met. The president has made it clear that he's committed to it and, if reelected, he'll do it.

MR. MANN: But whatever the level of spending cuts that the president would push and support, can anyone imagine that we can finance the federal government's activities that we all as a country agree on--defense, homeland security, domestic, social insurance--with 16 percent of the GDP? Because while you said the economic slowdown certainly affected the size of the deficit, it doesn't really affect revenue as a share of GDP. And the projection over time, if the tax cuts are made permanent, is that that will continue at 16 percent. So can we imagine, can the president state to the American people what a federal government would look like that's funded at that level?

MR. CAPRETTA: I want to go back to something Ron alluded to, which is that the president and many in Congress for many years have tried to look at the long-term fiscal situation sort of at its root, what is causing this, and that is fundamental factors and the design of the long-term entitlement programs. The president has made it very clear that he believes a shift in Social Security needs to occur more toward ownership of accounts, where people can count on wealth accumulation for their retirement and less on a formula driven by the Social Security system that is providing low returns.

One can do that. There are a variety of plans out there that can do that and reduce the long-term commitments of the government. There is no question that Social Security needs to be part of a long-term fiscal policy correction, and the president has made it very clear that he'd like to do it.

Regarding Medicare, there's been a lot of commentary about the Medicare bill. I think the one thing that is absolutely certain about the Medicare bill is there's a lot of uncertainty. The bill is very complicated. It added a new entitlement that both parties had pursued with vigor for many years. It was an inevitability that an insurance product for seniors was going to cover prescription drugs. It was a question of design.

Now, what did we get in the bill that can help, perhaps, change the trajectory of the program? Now, I take some exception with Bruce's comments that there was nothing. I think there were some things. Was there as much as some of us wanted? Probably not. But it was a very difficult political environment. We needed bipartisanship to get it done. And there are reforms in there that have the chance of, over time, being built upon to change the trajectory of the Medicare, including premiums that are income-related, for higher-income seniors, a new PPO network that will be a bidded system, very strong incentives for more private plans to participate, and changes in some of the cost-sharing structure. Not to mention on the non-Medicare side, a new product, HSAs, where there's real cost containment possible, where first-dollar coverage is more in the hands of the consumer and less in the hands of the insurance product, where more attention could possibly be paid to cost.

So I think the president's done quite a bit to get at some of the fundamental root problems of why there are imbalances in fiscal policy over the longer term.

MR. MANN: But over the shorter term--that is to say, now and the next few years--Social Security is actually contributing to the budget, not detracting from it. And we still have a 4 percent of GDP shortfall, a deficit. So we can't blame the current problems on Social Security. In fact, included in that 16 percent of GDP revenue figure are Social Security revenues. So we've got a problem in reconciling this if you're saying we're going to somehow get that 20 percent down to 16 percent through Social Security and Medicare when--I think realistically--most other analysts are saying those Social Security and Medicare costs, with the retirement of the boomers, are going to lift the budget to 30 percent of GDP plus. How are we going to grapple with that? So it's not a solution to the immediate short-term deficit shortfall we find ourselves in.

MR. CAPRETTA: No, but again I come back to the point that both CBO and the president budget did confirm that the president is on-path to cut the deficit in half in five years. Now, as a percentage of GDP, according to the administration's estimate, it's well below cutting it in half. So there are already policies in place that are going to provide a large bit of the short-term correction.

That is not to say that there isn't more that needs to be done, nor does that say that the longer term isn't a big issue, which is really driven by, again, the demographics--that are not more than a decade away--on the long-term entitlements.

MR. MANN: But that assumes no AMT fix beyond one year. It assumes very modest costs of war. It assumes the cuts in discretionary spending that the president has proposed. And most of the tax cuts are at the end of the five years, because that's when making them permanent would alter the basic baseline. So realistically, as Belle said this morning, and I think as Bruce said, it's economic recovery that will provide whatever relief we get in the short term. The real problem is just outside that five-year window. And then the real question is, if we're not at least up to even, even at that point, how are we going to begin to deal with the longer-term problems occasioned by escalating health care costs?--by the way, not just in the public programs, but in society as a whole and with the retirement of the boomers.

MR. CAPRETTA: Well, again, I think we accept the premise that long-term entitlement reform is necessary, and we pursued it as vigorously as we could within a bipartisan group, as much reform as we could get in the Medicare context. And the president has made it abundantly clear that he believes Social Security also needs to be addressed. That can be done in a way that I think the financial markets and others would all recognize would put us in a much better condition fiscally over the longer term.

Now, in terms of the estimates beyond '09, I guess I would just go back again to, as we were coming into office, the projections of the surplus. In some ways, the surplus was never there. I mean, everybody likes to compare where we are now compared to a $5.6 trillion surplus that did not exist. It was a projection based on not very good assumptions. So trying to project year by year the revenue stream over the next 10 years, let me just say, is an imprecise art.

In terms of the demographics, we know with much more clarity that we are facing demographic changes that are going to put much, much more pressure on the budget. I think we would be well advised to focus our attention on trying to get ahead of that as much as we can in a bipartisan way.

MR. HUNT: Let me ask Jason and Jim if they'd like to ask one question to the other. Jim?

MR. CAPRETTA: Oh.

[Laughter.]

MR. CAPRETTA: Let me call the Bush campaign.

[Laughter.]

MR. CAPRETTA: Actually, no, I did have one question, which I think is just a clarification, really, which is that the senator has made it clear that he would like to reinstate PAYGO for revenues and spending. But I think, as the previous panel made clear, the proposal put forward by the campaign is a net tax cut of several hundred billion dollars, by their own admission. The PAYGO rule that the Congress would like to reinstate applies to the current law baseline that they see up there. What's your position?

MR. FURMAN: Our position--

MR. CAPRETTA: Is that tax cut paid for or not?

MR. FURMAN: Our position is that, with President Bush in office, anything we can do to increase the constraints that he faces and increase fiscal responsibility would be good. So we would like to see all the tax cuts paid for, including extending the middle-class tax cuts. In the context of Senator Kerry's fiscally responsible plan, he is extending the middle-class tax cuts. Those are not paid for in the context of that plan. But everyone in this town assumes they're going to be extended. Everyone, when they're doing their baselines at Tax Policy Center, Brookings, Center for Budget and Policy Priorities, talking about a projected deficit, is assuming the middle-class tax cuts are paid for. And each and every new tax cut will be subject to that PAYGO rule that Senator Kerry is proposing.

MR. CAPRETTA: I guess I didn't quite get the answer there. Does that mean the PAYGO rule applies to the $500 billion-plus in tax cuts you say you're for, or doesn't it?

MR. MANN: It applies to President Bush, but not to President Kerry.

[Laughter.]

MR. FURMAN: That's not it at all. In fact, if anything, it applies to President Kerry. His college opportunity tax cut is subject to it, his health care tax cuts are subject to it. His other proposals are subject to it.

MR. CAPRETTA: But not the middle-class tax cut.

MR. FURMAN: What is exempted is actually the tax cuts that President Bush passed in 2001. So you had it precisely backwards.

MR. HUNT: Jason, do you have a question, then, for Jim?

MR. FURMAN: Yeah, I guess my question for you is, you know, our political folks in our campaign have been having a lot of fund with this OMB circular that went around about a month ago. And you talked about how OMB and CBO both certify that your budget cuts the deficit in half. We could submit a budget to CBO that they would certify balances the budget in four years, if your out-year non-defense discretionary number was, you know, $50 billion a year. I mean, it's the garbage-in, garbage-out principle. You can get anything from CBO you want because you pick those numbers.

In 2006, the president's budget has nominal cuts relative to 2005 levels--for veterans, homeland security, education, Head Start, and virtually every other area of the budget. We've been told that that's guidance that agencies will need to use in preparing their FY 2006 budgets. Is that correct, or am I misunderstanding something?

MR. CAPRETTA: Well, I was kind of hoping Dr. Rivlin would sit here and answer this question because she knows the drill. First of all, decisions about the '06 budget will be made by the president. And in each budget he has submitted, the budget has reflected his priorities. And that includes, as I articulated, winning the global war on terror, defending the homeland, and job growth and economic growth through tax relief and restraint elsewhere.

Inside of the restraint elsewhere, the president also has priorities. There were large increases in education funding in each of the president's budgets. There are large increases in veterans funding. But there are lots of places where the president believes the government ought to be restrained.

Now, the tables that get circulated around are nothing. There just essentially mathematical calculations. No policy has been decided, and they won't be decided until the president decides what he wants to do on the '06 budget. I can assure you, however, the priorities he's already articulated will be his priorities again. And that includes restraint elsewhere.

It adds up in the president's budget to a .5 percent increase in non-defense, non-homeland spending. If you want to know where he's cut the budget, go look it up. I'd like to see where Senator Kerry may be willing to cut the budget.

MR. FURMAN: Two very brief follow-ups. One is, when CBO certifies it cuts in half, I think they're using those out-year numbers. So tell me if that's right or wrong. The second is, the OMB had said that they were a mathematical extrapolation. But you look, some accounts go up, like defense, and some accounts go down. So it doesn't look to me like a mathematical extrapolation, it looks to me a little bit like priorities.

MR. CAPRETTA: There are probably some places in the budget where it's already known what the future path will be. Defense being such an important long-term planning component, they probably have some pretty good idea of what the future path may be in some accounts.

MR. HUNT: [Off microphone, inaudible.]

QUESTION: Separate for a moment the fiscal arguments from the long-term ebb and flow of the economy. A lot of the debate over tax cuts and spending cuts focuses on the perceived impact on the growth of the economy. But if you talk to people who are not connected with either campaign, you hear a lot of, well, the fact of the matter is presidents don't have as much control over the course of the economy as they like to say, and they're not as responsible for the downturns as we like to blame them for. And to listen to you folks talk within the campaign, that's not true at all, the engine of federal policy drives the ebb and flow of the economy.

Which set of experts is for the beans?

MR. CAPRETTA: Well, in some ways, I think I agree a little bit with the premise of the question, which is I think the president would agree that what drives economic growth in this country is entrepreneurship, the private sector, people creating jobs, the right incentives. And I think what's at work here is the president looking at the tax system and trying to make sure that it provides the right incentives for people to create jobs. We've been focused on this, as I said, like a laser ever since he took office.

But that does not mean he believes the federal government's a big machine with levers being pulled and people responding. I think he believes the federal government needs to set the right incentives through tax policy, through monetary policy and regulatory policy, and, as you said, the economy will take care of itself.

MR. HUNT: Jason, do you want to--

MR. FURMAN: Yeah, I mean, central to our macroeconomic argument is not blaming everything bad that's happened in the economy for the last three years on President Bush. We had 9/11, we had a tech bubble, we had a recession. There are a lot of things that were well beyond the president's control, as I tried to say in my remarks. Central to our case is that the argument that the tax cuts are what's causing a job growth and the tax cuts are working is something that we see no evidence whatsoever for in the data. And I think it's a very important debate for people to be having.

So that's the first thing. The second is there's no question that private sector is going to be what creates the jobs, the private sector is going to be what increases productivity. But there's a role that the government can play. The government can play a better role in funding innovation, some of the basic research that leads to long-term productivity growth, and we may even be talking not just a few tenths of a percentage point in the long-term growth rate, but that it adds up to a tremendous amount over decades. And it's something that, you know, I think Senator Kerry and President Bush have different priorities on, as 48 Nobel Prize winners said on Monday.

Or you can look at just something like the incentives about where you're going to locate your investment. Are you going to locate it, because of tax preferences, abroad, or are you going to locate it in the United States? And that's something that will have an effect on the short run and the long run. So there are a lot of important ways the government can get the incentives right as well as fund the investments that can increase the long-term growth rate. And we've talked a lot about our priorities in doing that.

QUESTION: Hi, I'm Jon Weisman with the Washington Post. By far the largest fiscal proposal on table, on the spending side, is Senator Kerry's health care proposal. By far the largest fiscal response to that is the repeal of tax cuts to households with income over $200,000. So I'd like to ask Jim, for one, why voters should not go to the polls thinking, in terms of domestic policy, that this is a choice between tax cuts and health care. And for Jason, why they shouldn't be thinking that, beyond this debate, health care versus tax cuts, that Senator Kerry really hasn't come up with a lot of the long-term solutions to problems of the deficit and other things looming on the horizon.

MR. CAPRETTA: Well, back to what I tried to articulate when I spoke, we think that the numbers don't add up in the Kerry fiscal plan, by about a trillion dollars. So the choice that you just mentioned I don't think is the choice. I think the choice is going to be between ballooning deficits or going back to middle-class tax increases. The hole is made up by about $300 billion in higher-than-reality estimates on the tax side, $200 billion in savings in the health care plan that I don't believe will be scored by the objective observers of the system, another $300 billion in the Kerry plan for what they call a corporate welfare commission that I think would take much, much too long to ever get done and very unlikely to produce anywhere near that kind of savings legislatively, and lastly, some savings on the discretionary side that I think will not be captured.

So, you know, you add that all up and it's about a trillion dollars worth of savings they're relying on to say their plan adds up to cutting the deficit in half. I just don't see it. I don't think that will happen that way. So the choice you're describing I don't think will be the choice that will be faced at all.

I would add also that the estimates rely on Dr. Thorpe's estimate of their health care plan. I think it needs to be assessed by others, because there are very large promises made in that health care plan that could induce--that need another look.

QUESTION: [Off microphone, inaudible.]

--follow-up--

MR. CAPRETTA: Well, again, I go back to the president has a budget that does add up, it does cut the deficit in half in five years.

QUESTION: So does John Kerry's.

MR. CAPRETTA: No, it doesn't. I just told you that I don't think that's the case. It would be great to have a budget--

QUESTION: [Off microphone, inaudible.]

MR. CAPRETTA: Yes, it is. It is 10.

QUESTION: [Off microphone, inaudible.]

MR. CAPRETTA: Well, we don't have year-by-year estimates from Senator Kerry, so it would be hard to know if this hole that I've described affects the five-year commitment or not. We'd love to have it. A year-by-year budget from Senator Kerry would be terrific.

MR. HUNT: We may be getting a little bit too micro, but picking up on Jonathan's question, Jason, would you agree, Belle earlier said that the first four years are the easiest; it really gets tough after that. Would you agree that, in the second Kerry administration, that you would have to engage in far more draconian cutbacks in entitlements, and tax increases?

MR. FURMAN: That's a problem I'd love to have, Al.

MR. HUNT: Yeah, but let's--

[Laughter.]

MR. HUNT: Let's assume you have it right now. How would you respond to it? [Inaudible.]

MR. FURMAN: Well, I'd like to answer Jonathan's question first. I mean, I think there are a few big issues at stake in this election. In my remarks I emphasized one of them more, which is fiscal responsibility. And I think there's a tremendous difference between President Bush--and I think his record speaks for itself--and Senator Kerry, who has both a record and a simple set of principles, which I said and outlined in terms of paying for all of his proposals.

But I also think there's a really big question of priorities here, and I think Ken Thorpe did a very good job of doing that. Which is, one candidate wants to repeal the Bush tax cuts for the top 2 percent of families, families making over $200,000 a year--and by the way, in the last year, when fully phased in, that's half of the Bush tax cuts would be repealed. It's not some trivial portion of them. Half of the money went in these seven provisions that we've outlined that go primarily to families making over $200,000 a year--and would like to use that money to invest in health care and education.

And the health care investments are both an expansion in the number of people covered--particularly people below 200 percent of poverty, which is one of the most progressive proposals I can remember in a presidential campaign, if you actually look at where the money is going in that Medicaid/SCHIP swap--as well as making health care more affordable while reforming the system through a reinsurance proposal that would not just increase fairness, but would also improve the effectiveness of the system by reducing the incentives employers have and insurers have to cherry-pick and try to get the healthiest cases, which will bring administrative costs down at the same time that it brings more people into the employer-based pool for health insurance, which will make the whole system function more efficiently.

So it's both a fairness issue as well as something that will make the health care system more efficient. And I think when people are voting in November, I think that's a very important question for them: Do they think the tax cuts that were passed in

2001 are affordable, and do they think that it is something that we can afford as a country not to address health care going forward?

That was in answer to your question. In answer to your question, Al, there's no question that we face a significant challenge in this country. And I think the first thing we can do when you're in a hole is to stop digging and to not make the problem any worse. So I think paying for all of your proposals is not something to be sneered at, especially in light of the last several years when Democrats and Republicans in Congress have put forward proposal after proposal without using the vocabulary of how it's going to be paid for.

Second, doing something on top of that to reduce the deficit above and beyond what you got to by paying for all your proposals is an important step. But third, we certainly are going to need to do more, and I think the only way to do that is with a president that can bring both parties together and address that challenge in a bipartisan fashion.

MR. HUNT: And Jim, did I understand you to say that the estimated one trillion dollar Social Security transitional cost, if the president goes ahead with his Social Security proposal, is not really a fiscal issue because it's a short-term expense?

MR. CAPRETTA: I think the right way to look at Social Security is that moving toward personal accounts, done right, can actually substantially our fiscal situation, not worsen it.

MR. HUNT: In the long run.

MR. CAPRETTA: In the long run.

MR. HUNT: When we're all dead.

[Laughter.]

MR. CAPRETTA: Well, you know, Social Security reforms always are done over the longer term. They were done that way in '83, they'll be done--you know, these things take a long time to be phased in. And, you know, much of the cost of the Social Security system is already built in. We've already promised people benefits. The question is how do you finance it in a way that is going to provide the best return for the people. And there have been many, many plans put forward that point in the direction of providing a better return for the amounts people are paying in, and making the system more solvent.

MR. HUNT: Tom is on the edge of his seat.

MR. MANN: Isn't the case, though, on Social Security that, when push comes to shove, to make the system whole you have to have some combination of more revenue and fewer expenditures? Those who want private accounts have good reasons, apart from, presumably, cost savings, to want those. But you're really counting on an ability of "the system" in its entirety to generate higher returns than would be generated in the present system. That's a big gamble, and it's highly debatable as to whether that could happen. Most people looking at Social Security say: You want to fix it? It's got a long-term shortfall of a couple of percent of GDP, so increase revenues and decrease expenditures by raising retirement rates, changing formulas, and the rest. Isn't that something that will have to be done with Social Security?

MR. CAPRETTA: Well, I mean, first of all, I don't think it's a small matter say, eh, just increase the revenues, you know, a little bit. I mean, as I think the other side correctly points out a lot, people pay a lot of payroll taxes. I don't think they're really anxious to have them go up.

I think the key to this is to figure out how to provide, for what's being paid in, the best return possible in some kind of framework. You know, the current system is not financed. In other words, the benefits that have been promised really are not paid for from our current tax structure. So the question is how can you get the most you can from the amount that's being paid in. And the president believes personal accounts is central to that.

MR. HUNT: But the thrust of the question is if you're true to Social Security reform and if you really had any logical approach at all, you would talk both about increased revenues and cuts in benefits. And it's worth pointing out that not only neither of these candidates, but virtually no politicians--there are very few that propose any kind of cuts in Social Security. And when people do, they're slaughtered by other politicians. So how can we get to a point where there are actual proposals about, okay, you're not going to get Social Security till you're 67, without that person losing the next election?

MR. MANN: We're already scheduled to go up to 67. We got that in '83, right? It's about setting it off in the future as these provisions kick in and finding some bipartisan cover for achieving it. That may answer Belle's question. Divided government may be the only way to achieve it.

MR. HASKINS: Experience shows a presidential campaign is not a place where you're going to get proposals of this sort, and neither side has put anything on the table that's going to respond to your question.

MR. MANN: Right. Exactly.

MR. HUNT: Let it be noted that Jim and Jason were perfectly content to let Tom and Ron discourse on this stuff.

We have time for one more question, I think. Bob?

QUESTION: This is a question for Tom Mann. Is all this discussion we've been having about these various budget plans and their accounting realism or whatever--they have any relationship to political reality? That is to say, if John Kerry is elected, is there any possibility in your view that he will be able to convince Congress, even if the Democrats win that Senate by a marginal couple of votes, to enact something like his health care proposal and his education proposals? And on the other hand, is there any prospect that President Bush would actually be able to convince Congress, Republican or Democratic, to have the kind of spending restraint that is in his budget?

MR. MANN: In the likely or even conceivable political makeup of the Congress under either a Bush reelection or a Kerry election, neither candidate would be able to achieve his objectives in full, or anything approaching them in full. Therefore, what you have to look at is, one, you have to look retrospectively--what's transpired, what's been the record of administrations. It's easier, Bob, to advance an agenda through a narrowly divided Congress that distributes benefits, rather than one that assesses costs. So that's certainly a consideration.

On the other hand, there comes a time when you begin getting scared, the possibility of which Bruce reminded us this morning. And I think there are now enough people scared about the long-term fiscal dangers of tax cuts and higher social insurance spending that it will be more difficult for either of these gentlemen as president to distribute additional benefits.

So to the extent Kerry asks for a repeal of the tax cut for those earning over $200,000, I actually think that is achievable in this fiscal environment. How much of his health care plan that would emerge, I'm not sure. Do I think the tax cuts could be extended permanently if Bush is reelected? No--not in this environment. Do I think that the Congress would pony up a trillion dollars for the transition costs to private accounts in Social Security? No, I do not. So we would operate politically in a much narrower policy arena.

MR. HASKINS: Can I just--I want to add [inaudible].

[Laughter.]

MR. HASKINS: You wrote a column in 1995 and I think the Washington Post labeled it, or you did, "The Problem Is Spending." And I would point out to you as a footnote to Tom's answer that the Congress in 1995 passed legislation that cut almost a trillion dollars in spending--passed both houses of Congress, several Democrats supported it in both bodies. So if precedent means anything, it is possible for the Congress to pass huge cuts in government programs. And that would be part of a real budget solution, I think.

MR. FURMAN: I think that it's very important for us to put out detailed proposals, ones that people can evaluate and understand and see how they add up. But it's also very important, and I tried to emphasize here, the principles and priorities that a President Kerry would live by. And so some of those principles, like paying for proposals, and some of those priorities, like health care and education, are ones that would guide a Kerry administration. We'd like to implement each and every campaign promise. But to the degree you need to compromise and make political choices, those will be the principles that will not be compromised and will guide all those choices.

MR. CAPRETTA: Just to reestablish the point, I think Senator Kerry's emphasizing his principles on fiscal restraint, but he did admit that his tax cut would be exempt from PAYGO as well. So that's a big exception.

MR. HUNT: I want thank everybody. I want to thank Jim and Jason and Ron and Tom for a very stimulating presentation this morning. Lots of guideposts to think about over the next five and a half months. And I want to thank Belle and Ron and Brookings for putting this on. And most of all, I want to thank you all for being a terrific audience.

[END OF TAPED RECORDING.]

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