A Brookings National Issues Forum

The Social Policy Agenda: Crowded Out Or Moving Up?

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Welcome and Introductions:

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Panel I: The Political Context

THOMAS E. MANN
Senior Fellow, Governance Studies, and W. Averell Harriman Chair, Brookings

BRUCE REED
President, Democratic Leadership Council

THE HONORABLE BILL FRENZEL
Guest Scholar, Governance Studies, Brookings; Former Member, U.S. House (R-Minn., 1971-91)

Panel II: The Economic And Budgetary Context

RUDOLPH G. PENNER
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Senior Fellow, Economic Studies, Brookings Co-Director, Welfare Reform & Beyond

Panel III: What Could Or Should Be On The Social Policy Agenda

RON HASKINS
Guest Scholar, Economic Studies, Brookings

TOM LOVELESS
Senior Fellow, Governance Studies, Brookings; Director, Brown Center on Education Policy

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THIS IS AN UNCORRECTED TRANSCRIPT

MR. E.J. DIONNE, JR: -- on the reauthorization of the expiring 1996 Welfare Reform legislation, we're blessed with Ron Haskins who will explain all of that to us later and tell us what comes next.

The question is what is going to happen with social policy. The truth is, it is impossible not to have a social policy because not to have a social policy is itself a social policy, as you remember that old saying "not to decide is to decide." And in fact there are a whole series of social policy problems that the electorate very much wants addressed and that in the congressional elections around the country beneath the sort of top line of war and economy, issues concerning health care especially and welfare and other issues were very much in play and in debate in these elections. So we're blessed today to have superb panelists to put all this in context and to predict fearlessly what will happen in the coming year.

I will not ask them to address what is a very important issue in American politics right now which is how they would have voted in the 1948 election, but if any of you want to raise that question you are welcome to do so.

We're going to have three panels and I just want to explain in advance how it's going to work. The first panel and the third panel will be informal discussions. I would say unplanned, unrehearsed, but there was some planning that went into it so that wouldn't be true. But they will be informal discussions.

The middle panel will be a little bit more formal. The reason for that is the middle panel is about whether there will be any money to be spent on what is discussed in Panel I and Panel III. So in the middle we'll have a discussion and perhaps a little bit of debate on the country's budget situation.

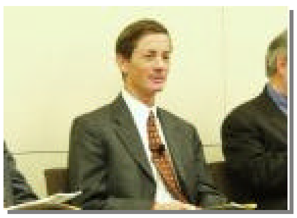
The first panel is on the stage right now -- Bruce Reed, Tom Mann and Bill Frenzel. We have asked, Bruce does that wonderful inside-the-box feature in *The New Republic*, as you know, so we thought he could lighten up your morning for us as we began. Bruce in his part-time, when he's not writing these very funny items, is the President of the Democratic Leadership Council. He runs the DLC's Progress and Prosperity Project. He served for eight years as President Clinton's Chief Domestic Policy Adviser and Director of the Domestic Policy Council. I think there were moments when Bruce was the only person who could talk to everybody in the White House because he has worked for both Bill Clinton and Al Gore and continued to talk to both of them throughout the Clinton Administration.

Tom Mann, as you know, is W. Averell Harriman Chair and Senior Fellow in Governance Studies at Brookings. He's the former Director of the American Political Science Association, has taught at many universities, and he is working on projects related to campaign finance reform and election reform in the U.S. and around the world.

Finally, but not last at all is Bill Frenzel, a Guest Scholar here at Brookings. He's a member of the President's Commission to Strengthen Social Security. He was a distinguished member of the U.S.

House of Representatives, a Republican serving from Minnesota between 1971 and 1991. He was the Ranking Minority Member for the House Budget Committee and the House Administration Committee. He also served on the Ways and Means Committee, that is the powerful Ways and Means Committee. He was also Congressional Representative to the General Agreement on Tariffs and Trade.

I'm going to move to my seat, but while I do Bruce can start. I wanted to ask you Bruce, is there any social policy out there, and is there any incentive for Democrats to come to agreement with President Bush, or for President Bush to come to agreement and compromises with Democrats? Welcome, all.



MR. BRUCE REED: Thank you again.

I'm not going to tell many jokes this morning. I figure that my party's done enough to make America laugh in recent months.

I think the question posed for this panel, is social policy crowded out or moving up? And I would give E.J.'s favorite answer to any question which is both and neither.

For a variety or reasons I think social policy is inevitably going to continue to be shunted aside to a considerable degree simply because there's not enough oxygen in the political debate and not enough room in the newspaper to support much discussion of domestic issues in the midst of war.

This Congress does not seem eager to pass things even when it's under intense pressure to do so and I don't think it will be in any hurry to get anything done, although there will be pressure from the White House. Which is the reason, I think, that social policy will still be in the game.

As perhaps the oldest living survivor of the Clinton, the last Administration to be in this position in a run-off to a reelection effort, I can tell you that there will be enormous pressure from inside the West Wing to get things done and everything that this Administration did try to twist arms to keep things from getting done in 2001 and 2002 will be reversed. You get to a point where you lose patience with your congressional friends who say you can do that next year. The attitude in the West Wing is if the President doesn't get reelected there won't be a next year.

I think there's another reason for the White House to step up its efforts, which is that they do have some problems here on the home front and the President seems attuned to at least seeming to care about those problems.

You know you're in trouble when your economic plan is costing more jobs on your economic team than it's creating in the country. [Laughter]

By the way, if anybody can explain to me why it is that absolutely everyone who served in the Ford Administration went on to become a CEO, -- [Laughter] I'm hoping that it is some miracle of compound interest, that when you're out of an Administration for 25 years you suddenly become fabulously wealthy. [Laughter]

Another advantage that the White House will have is that I think Democrats are in an even more weakened state, if that's possible to imagine. I think the best metaphor for the Democrats' current plight is the stories that came out a few weeks back about scientists who found a way to combine stem cells from humans and mice. I think this could be the answer to the Democrats' prayers, because on issue after issue the voters have been asking, "Are you a man or a mouse?" and our attitude has been, "You mean you want us to choose?" [Laughter]

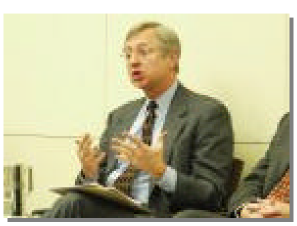
So I think there will be something of a minor renaissance in social policy. I'm less optimistic that many social problems will get solved. I felt like I have had an uncharitable and cynical view of this Administration's motives until John memo made me feel like I wasn't being cynical enough. He said some nasty things about my successor, Margaret [Lamontayne] which were unfair and not true. He said that what she knew about domestic policy you could fit into a thimble which is absolutely not the case. She did a very good job on the Education Reform Bill. But I think it's fair to say that among the political theme in the White House, and perhaps the political theme in any White House, the amount that they care about actually solving social and domestic problems could at times be fit in a thimble.

I think that an Administration cannot succeed over the long haul if its primary motives are political rather than to actually solve problems. The attitude of political advisers around a President is always like the old Tom Laur song about Werner von Braun. "I just send them up, who cares where they come down." [Laughter] That's not my department, says Werner von Braun.

MR. DIONNE: Thank you very much.

Incidentally, I want to welcome the people watching this on the WebCast before a warm fireplace. I also want to note that Ron Nessen, who just went out of the room, a veteran of the Ford Administration, will answer Bruce's question about how you join the Ford Administration and become very rich. Thank you.

Tom, can you talk about -- There are two clear domestic policy issues that the country cares passionately about. One is health and the other is retirement. What is going to happen on those issues in your view? What should happen? And also we do not want to be cynical and say that domestic policy is entirely linked to politics, but what effect will all this have on the 2004 elections?



MR. THOMAS E. MANN: I actually think it would be a tremendous mistake if we fail to see the link to 2004 because certainly President Bush and Carl Rove and others within the Administration see a clear link and they're quite explicit about it. It seems to me that the segue is the Mayberry Machiavellians from Bruce to me, but it seems to me it is always a tremendous mistake to underestimate the boldness of this Administration or the political judgment of this Administration -- the President and Karl Rove and others.

In my view this has been an Administration of enormous political and policy ambition. In some ways almost inversely related to the size of the 2000 electoral mandate. This is an Administration that is prepared to play a weak hand. It's prepared to play a strong hand. And it has in mind building something substantial. That something substantial began with the successful mid-term election. It goes from there to a successful reelection for the President, but it goes well beyond that to a desire to try to frame the basis for a Republican majority in this country. And frankly, it would be impossible to conceive of doing that without wrestling with some of the critical domestic social policy issues. So I think President Bush, as advised by Karl Rove and others, are thinking in rather bold terms about social policy for the next several years, and then the four years beyond that as they see it. So it's moving up rather than being crowded out.

I think they also understand two other things. One, they have drawn explicit lessons from President Bush 41 and are absolutely determined to have an active, aggressive domestic and social policy agenda for the next two years.

Secondly, I think in the privacy of their offices away from the media they would acknowledge Bill Clinton's success in finding the center in American politics and articulating issues that resonate with the broad American public. And for them to ignore those issues is to put themselves in political peril.

My view is that they have two primary domestic policy priorities for the next two years. Certainly the most important is economic growth and we will see a very ambitious stimulus package. There will be more talk about that later in the morning. But I think you will see the Administration make the argument, which is a legitimate argument, that the best social policy is economic growth, and much of their energy will be directed in that way.

But the second broad area I believe will be health policy. A fascinating thing is happening in this country. There is a renewed call for universal health coverage and it's coming from all parts of the political spectrum. It's coming from Al Gore, it's coming from the business community, ideas are being generated in conservative circles and liberal circles and in moderate circles.

I expect this Administration to have a very ambitious health agenda and one that allows it to pursue approaches and ideas very different than those that Bill Clinton pursued, but ones that respond to the same sentiment out there in the broad public.

I frankly think we will see little happening. Ron will educate me properly on this later, but I think the sort of welfare reform issue ends up being sort of very modest incremental efforts. I think the education initiative has been launched. There are great complexities and problems in implementation and insufficient funds. We're not going to hear a whole lot about that. The faith-based initiative will go forward in a halting way. I believe that the retirement initiative will prove too troublesome politically. The President wants to do it and I think there will be some initial efforts, but I don't think it will go anywhere. There will be modest steps in the abortion arena, late term, but everything is going to come down, in my view, in terms of priority beyond economic growth, to health policy.

The final question then is are we talking here words or deeds? Are we talking issues or new laws?

The Bush Administration and President Bush in particular has been exceptionally skillful in using a kind of soothing rhetoric to make at times more palatable an agenda that's been more conservative. Republicans in Congress have been very skillful in framing alternatives to Democratic proposals on a range of domestic policy issues that have blurred differences between the parties and kept the Democrats from gaining any traction.

The question is now that Republicans have regained control of both houses of Congress with the White House, whether they will feel obliged to produce laws as well as positions for debate in the next campaign. I think the answer to that is yes, but whether or not they succeed is quite another matter.

MR. DIONNE: Thank you very much. I think that when you talk about the President's appreciation of Clinton's discovery at the political center, and one of the things I would like to talk about is to use, I believe I've got this word right, the nice word the President used is the [center craw fishing] to the right, and how is that happening.

But before we get there I'd like to ask Bill Frenzel the broad question and the particular question that Tom raised. Could you from your perspective tell us what you think the priorities of the President and the Republican majority in both houses will be? What will their priorities and social policy be? And in particular, will the President ask the Congress to approve a system of private accounts under Social Security?

MR. WILLIAM E. FRENZEL: Thank you, E.J. I thought you'd never ask. [Laughter]

I don't disagree a great deal with my colleagues on this panel about what's going to happen and what the priorities are. I think I have a slightly different viewpoint but many places we intersect.

First of all you will recall that reauthorization of the Welfare Reform Act of '96 foundered on the shoals of the Democrat majority in the Senate last year. That's going to be a number one priority and that is going to be reauthorized this year.

I should say too that the shift from off-shore to on-shore in terms of thrust begins with the economy but it does drag the social agenda along with it. I think both of the other speakers indicated that.

Remember we have not funded the Education Bill of 2001. Not only does the President have a huge political investment there but both political parties do and that's certainly going to move ahead.

I don't foresee the broadscale health developments that Tom does, but again, everyone has a substantial investment in Medicare. Drug benefits may range from parsimonious to rather expansive. My guess is what's going to be passed is going to be more toward the former than the latter, but I believe there will be a bill enacted this year on Medicare drug benefits.

The interesting question to me was the most recent one that E.J. posed, and that is, is the President going to recommend to the Congress that Social Security be modified to include private accounts in the system. I don't really have the answer to that, and I think partly it depends on how crowded the agenda is and how many balls the President can keep in the air at once.

I think if we don't have wars and major terrorism events that yeah, there's a pretty good chance. I think the President feels very strongly about private accounts. I think the White House looks on the mid-term elections as a vindication of the President's position. National polls look pretty good. It doesn't mean it would get through the Congress this year or even this biennium, but it would not surprise me if he served that issue up to the Congress.

If the agenda is crowded, if there's heavy going, maybe not. Maybe it will be one that is held back. But clearly it's important to the President, he believes in it, and he is one like the public that senses whatever you're going to do you better do it rather promptly or it's getting more expensive every day and it's going to come back to bite you.

I see that as a possibility on the agenda, not necessarily a probability. But I see education, welfare reform and Medicare as sort of the leaders in the social policy agenda. Both for the Congress and in some cases both parties in Congress, as well as the President.

MR. DIONNE: Thank you, Bill.

Incidentally, we are going to go to the audience for questions so those of you who want to do that if you can cook up your questions there will be mikes going around the room in a little bit.

Just to follow up, Bill, if the President did decide to go to private accounts, you know better than anyone, having served on that commission, that the cost is very substantial and the cost comes at a moment when, as we'll learn on the next panel, the government is just a little bit short of cash.

How do you solve that problem? Not necessarily how will the President solve that problem, but you've grappled with it yourself. How can one solve that problem?

MR. FRENZEL: How do you hold a moonbeam in your hand? [Laughter]

The answer is that the cost of not doing anything is more expensive ultimately than the cost of doing something. And so it is better I believe to accept those costs early. If it entails additional borrowing, so be it. But the cost of not doing anything means that either benefits foregone or taxes increased in the future are just too heavy a price for our children and grandchildren to pay and we're going to have to suffer a little right now.

MR. REED: Can I hazard a guess on that?

I think Bill is undoubtedly right on the merits. My guess would be, the challenge to the Administration is the Republicans think this will be Bush's second term agenda and Democrats think if this is Bush's second term agenda there won't be a second term. But I think the President very much wants to look bold on this issue.

My guess would be, I tend to agree with Senator Moynihan who said that we won't really deal with the financing crisis for Social Security until about five months after it's hit us. But it wouldn't surprise me at all if the Administration decided to add on accounts somewhat like what President Clinton proposed without any fundamental changes to the structure of Social Security, so you get all of the sugar and none of the pain.

I know this Administration is deeply, deeply concerned about the deficit, but -- [Laughter] -- I suspect that giving away money to help people save might be a politically [inaudible] [salute] in their view, even though it might have serious long-term fiscal consequences.

MR. DIONNE: Tom, do you have a thought on this?

MR. MANN: Politically Bruce's solution which was Clinton's solution which was an add-on, obviously means tested to encourage the development of saving patterns, private saving patterns among low and middle income citizens has enormous attractions politically because it doesn't lead to any restructuring of Social Security, doesn't lead to any decline in guaranteed benefits. But obviously it doesn't either deal with the long-term financial problems of Social Security. But then I would argue neither does the sort of private accounts without the reduction in the guaranteed benefit levels.

So we're still talking about reducing benefit levels one way or another.

My view is that the deterioration of the budget and the disappointing performance of the stock market over the last three years have together created an enormous political hurdle for moving in this direction.

So my view is Bill and Bruce are right. The President will put something on the table. He will be very bold in that regard. My prediction is that Republicans will run away from it and that if anything happens it will be an add-on account which in effect worsens the long-term fiscal problem rather than improves it.

MR. DIONNE: Could people who want to ask questions identify themselves? I want to throw out one more question, but our friends with the mikes can get to you and you can have the mikes.

Obviously no one likes to ask the first question, so who wants to ask the second question? [Laughter]

I'll ask my question and then you can identify yourself.

Faith-based initiative. The President could go two ways on that. He could try simply to get the compromise worked out with Senators [inaudible] and Lieberman and Clinton, just get that on his desk fast; or now that he has both houses of Congress he could go back to something that might be seen by his side of any event as more ambitious. Bruce? Bruce in particular, but anyone else, if you have a view on it.

MR. REED: I think over the next few years in particular the White House will be extraordinarily goal oriented. The President is anyway. He had his list of four things in Texas. He has his list of six things for this term. I think he wants to check the box on space-based, and they play a very good poker hand so it may look like it's not going to happen until the last possible moment but I can't imagine that given how important it is to Karl Rove's political strategy, and I think the President generally believes in it, that it won't happen.

MR. FRENZEL: As you know, there are things he can do right now under the law and those will go forward and those will be trumpeted. My own guess is that he would like to proceed as he was proceeding last year and get something that isn't quite forcing, that doesn't rely on his party all the way. I don't think -- I wouldn't guess he'd go for the steamroller, but I think he'd like to pick up where they left off last year.

Again, that's sort of a core constituency issue with him, and I think he has to be moving it.

MR. MANN: I agree with my colleagues. This is a case where he will step back from the most ambitious initiatives, not take the opportunity of the change in party control in the Senate, settle for something he knows he can get, check the box, and campaign on that success.

MR. DIONNE: I can't resist asking the author of that new political treatise, Of Mice and Men, to comment on what are Democrats going to do about all of this? Do you see them emboldened by defeat? Do you see them pushed back by defeat? How will Democrats grapple with social policy and obviously I suppose to paraphrase the President, it depends on what the meaning of the word Democrat is. [Laughter]

MR. REED: If we were [emboldened by deceit] we would be a very very strong party. [Laughter]

My guess is that I think Democrats, that the national Democratic message will improve over the next two years simply because there will be presidential candidates who are making it and there are only a couple of them. So instead of having 27-0 spokesmen we'll have three or four. So I think the White House will be under more pressure on the big picture from Democrats, but I think on the Hill Democrats were in a tough spot even with nominal control of the Senate, and I think there are, in the areas where the White House wants to get a deal -- faith-based, prescription drugs, a couple of others, there are plenty of Democrats who are tired of the politics of those issues and wouldn't mind going down the roadside once or twice.

MR. FRENZEL: May I comment? Because I think that needs emphasis. I have the same feeling Bruce does.

It is relatively easy to push things through the House, and having been a member of the suppressed minority there for 20 years, you got a lot of footprints on your face. You can't stop things very readily.

But in the Senate where the rule is if you've got 40 friends you rule, there is going -- Despite the fact that the Democrats have lost control of the majority and therefore the agenda, does not mean that they have lost control of the substance. They still have a great ability to either accept or deny that which goes through.

It seems to me that the Democrat Senate will be the core of resistance if there is resistance, and it will be the core of compromise if there is to be compromise. But having been a member for most of my life of a party that acts like Bruce is describing his own, the worm always turns. [Laughter]

MR. DIONNE: We have mice and worms. We're going to keep adding --

Tom, I want to ask you in this context, Representative Bill Jefferson of New Orleans, a fairly moderate Democrat himself, said that the lesson of Mary Landrieu’s recent experience is that you vote with the President, you support the President, and as she put it, they come down here and stomp on you.

Do you think there is any bitterness inside the Democratic party about the partisanship, especially around issues like homeland security, that might get in the way of what Bruce was talking about in terms of wanting to get to the rose garden?

MR. MANN: None whatsoever. The Democrats -- [Laughter] The Democrats are feeling as if the President offered to govern on a bipartisan basis, he's entirely sincere, and they're looking forward to a cooperative relationship on a range of issues. [Laughter]

MR. REED: We should make note for people reading the transcript that that was --

MR. MANN: Full stop.

It is poisonous on Capitol Hill, make no mistake about it. Democrats were embittered before the election. They believe the disjuncture between the President's rhetoric and his actions is stark. They saw what they took to be a blatant politicization of domestic security issues. Of course they didn't resist it effectively, they dropped the ball and acted like wusses and therefore got beaten very badly. But now with the Landrieu victory in Louisiana they're beginning to feel their oats. They see themselves as the opposition party. They're thinking like the Republican House leadership thought when Bill Clinton was in the White House. They want to frame issues for the campaign rather than reach agreement with the Administration on a whole range of matters.

The question is, will the President make it easy for them to do that or difficult for them to do that? He could make it very difficult for them by coopting them, by moving on matters like unemployment benefits, on minimum wage, on rebates to those who pay payroll taxes as part of an economic stimulus package by putting something substantial on the table with respect to prescription drug benefits. It will be fascinating to see the extent to which the President and Karl Rove complicate the Democratic plans to be the opposition party.

As I said at the beginning, I would not underestimate the political judgment of this White House and the skill with which they may approach that task.

MR. REED: I think Tom's onto the central question and I think the White House will show considerable skill. But the real question is will congressional Republicans be emboldened by victory because look, if the White House wants to get a deal it can get a deal. But only if its own party will let it do so. We said throughout the campaign that Republicans were going to turn back the clock, as you point out. We didn't think 1948 was where they were going to stop. [Laughter]

QUESTION: Rick McGahey with Apt Associates.

You mentioned a lot of topics. We didn't mention the tax code. I suppose tax cuts are the next panel topic. But there's often talk about changes in the tax code. Glen Hubbard's known to be someone who's looked at consumption tax basis for a long time and that's occasionally floated as a topic. [It stands in tension] with our use of the tax code to institute social policy, right? Health, housing, income, retirement policy, we all do it through the tax codes and then we talk about how complicated the tax code is becoming.

I was wondering if anyone had a sense about, do you see any movement at all towards a broad statement about changing the tax code to some kind of consumption-based tax?

MR. REED: Yeah, the movement's in the direction of Pittsburgh, as near as I can tell. [Laughter]

MR. FRENZEL: If you recall 1986 to 1987, perhaps 1969, comprehensive changes in the tax code are exceedingly difficult and without powerful leadership from the President, whoever he may be, they simply aren't going to happen. Congress can't handle that stuff by itself. Some of its constituents are for it and some are against it and it's with its constituents so it just isn't going to happen.

It looks to me like there have been firings. DEA and Treasury both, both NEC but I haven't heard of that. But again, the schedule is pretty crowded this year. The President's attention is directed elsewhere. I don't think he's got the time or total resources to work on comprehensive tax reform that would include the matters you're suggesting.

I think it is unlikely as you assess the priorities coming on that those items are going to filter through individually in smaller tax bills. There isn't, under the budget rules there isn't a way to finance them and I just don't think they can fly.

MR. MANN: I think that's right. Paul O'Neill was more interested in tax reform than tax cuts, and I think that clearly diverges with the priorities of the Administration for the near term. I could see that being an agenda item for a second term just like Social Security restructuring. But you're quite right. On most of the social policy issues you will see a major tax component, but that will have the effect of further complicating the tax code, not simplifying it.

MR. DIONNE: In the 1950s under President Eisenhower an awful lot of social policy was done under the name of defense policy. We had the National Defense Education Act which helped send me to college; we had the interstate highway system which was partly justified on national security grounds. I would imagine somebody making an argument that we need to spend more on education because then educated kids will be better able to defend the homeland.

Do you see any ways in which this homeland security concern gets played back into something having to do with domestic policy? National service is certainly one possibility there where it's actually a real link.

MR. REED: I hope so. I'm a little worried the Administration won't even do enough on homeland security as homeland security. They've been slow to put their money where their mouth is on that issue and I think Democrats will put a lot of pressure on them and eventually they will do so. But a related question is over the next year leading Democratic presidential contenders are going to put new [stocks] on the table an try to inject some [bullish ideas] into the debate, and what will the Administration do to try to head them off at the pass? I think that may lead to more attention to an issue like education than it would otherwise.

MR. FRENZEL: My judgment is the President's job is to keep homeland security on a national basis. The Congress as it accepts its responsibility is to screw it up and make it into local grants that will do something in its own district. So we want palm pilots for sheriffs and armories and university grants and tennis courts and whatever. [Laughter] That game is going to be played on a continuing basis.

My judgment is the President will try to keep it aimed at having a bona fide national homeland security program rather than letting it fractionalize into at least partially social local endeavors.

MR. MANN: I've got to respond to that. I would make the argument that had Congress sent some money down to states and localities to help them prepare as first responders to various contingencies and foregone the Homeland Security Reorganization Bill, we'd all be a lot better off.

What we've done is had a sort of bureaucratic political game in Washington while genuine efforts at state and local governments to begin to do something have been constrained by the horrible fiscal situation that state and local governments are in now, and the failure of the Feds to put the dollars where their new mandates are. So this in my mind is just the opposite case.

Oftentimes Bill is quite correct, things get noble intentions in Washington, get dissipated and in pork. This is a case where the Feds would have done much better, played a much more constructive role by sending the money where it's needed and turning their attention elsewhere.

MR. DIONNE: The report may be the real meat of homeland --[Laughter]

QUESTION: Following up on what Tom said, I'm Mark Nadell, Social Security Administration. Following up on what Tom said, do you see any action on the part of the federal government to help alleviate the fiscal crisis in the states?

MR. FRENZEL: That's a wonderful question. At least 50 Governors are swarming all over Washington now trying to find a way to get some money in to relieve their own distress at home. I think they will find a very sympathetic audience of people here who will agree that life is tough all over but in the end they'll come to the Jimmy Carter conclusion that life isn't fair and the federal government will have its own deficit to contend with in some of the programs we've been discussing here. I don't see any major programs going back to the states.

In the first place they're terribly complicated to construct. When we were in the old "new federalism" mode in the Congress we had a terrible time sending money back. The direct revenue sharing was in some ways the best and in some ways the worst. In any case, it was always conditioned on federal stipulations and conditions. That's pretty complicated work. Unless we had something on the shelf that was ready to go I would think it would be very unlikely that there would be any major infusions of revenue transfers to the states.

MR. REED: I don't understand on this, Republicans who invented the new federalism, direct revenue sharing, looking at a situation where Governors are having to act absolutely against the interest of economic growth. They not only have to raise taxes, they've got to cut spending, and why Republicans haven't made this their own cause. You have an obvious way to do this, which is to help states with Medicaid costs. It doesn't raise some of the problems of how do you write a formula for revenue sharing. Why haven't they picked up on their own tradition in this area?

MR. FRENZEL: Simply because financing a government is a competitive sport. And it's a contact sport. I ran on revenue sharing and defeated my opponent on that issue by three-tenths of one percent when I first came to Congress. But I have to say that I am more and more persuaded that the separation of fundraising and fund-spending causes a real problem.

I just don't believe that Congress, with whatever funds it has, is going to be terribly willing to share them. I will admit that rationally states being burdened by constitutional restrictions on taxes and to have balanced budgets have got the toughest job in the world. Anyone that got reelected Governor this year got the short straw. The federal government, on the other hand, can borrow money and in times of stress does it, and sometimes when they're not stressed they do it too. But I just don't see them sharing. It doesn't look to me like the Congress and the President's budget adventures over the last 20 years furnish any comfort to anybody in this situation that there is going to be an important sharing.

MR. MANN: It would be more defensible for the federal government to simply withdraw from this if their hands were clean. But remember elements of the 2001 tax cut had the effect of further reducing revenues at the state level. And secondly, if you go inside the Education Bill and you go inside the expectations regarding homeland security, you will see that the federal government is putting additional burdens on state and local governments in a way that are going to have to be financed by those, in large part by those state and local governments. So the feds have put the squeeze on. They're now talking as if, “oh, deficits don't matter at the federal level. We need more stimulus.” It seems to me it's not unreasonable for an element of a stimulus package to include some fiscal aid to the states. But Peter and Rudy and our next panel will explain why that's either ridiculous or very wise policy.

MR. DIONNE: It's a perfect transition. We should shut this one down real quick. And Bruce, you can have the last word.

By the way, we are going to try to find Bill Frenzel's opponent in that election and send him a transcript -- [Laughter]

MR. FRENZEL: He didn't vote for Strom. [Laughter]

QUESTION: I'm John Workman with the Consortium of Social Science Associations.

I want to quickly ask a related question. Senator Daschle had a meeting this week where he trumpeted the Democratic Governors who just won. Do you think along those lines the Democrats can sort of try to get their message out through these new Governors?

MR. REED: I think we have some wonderful new Governors who will be articulate spokespeople for the party for years to come, and I do think that it makes an enormous difference to be at parity in Governors instead of being far, far behind as we were in 1994.

I think that will -- perversely I think that may make it more difficult to get money out of Congress to help solve states' fiscal problems since there won't be quite as much sympathy in a couple of key quarters. But I do think that Michigan and Pennsylvania are central to the President's reelection and it's not going to be just for his politics over the long haul, it's two very articulate Democrats are beating up on him in a sustained way in those two markets.

So my prediction would be that the easiest way for an Administration to show that it's doing something on education, on health care, on homeland security, is to shift the money out to the state and local level. They won't be particularly generous about it, but I bet they try to check that box as well.

MR. FRENZEL: I would add that the Republicans elected some fine new Governors too and if the Democrat Governors are smart they will stand shoulder to shoulder with their Republican allies, let the Republicans be the spokesmen and they can take the heat if the Administration doesn't like the message.

MR. DIONNE: On that happy note. What we're going to do, I think we're going to take about a five minute break and then we're going to bring up the new panel. Grab a cup of coffee. Thank you so much Bill, Tom and Bruce.

[Applause]

[Break taken]

MR. DIONNE: I'll start it up as the rest of the folks come in.

When former Governor Edwin Edwards of Louisiana was running for reelection one year the state's economy was in a very difficult shape and Governor Edwards knew what his reputation was in the state, so he went all over the state and said if my opponent is reelected there will be nothing left for me to steal. [Laughter] That is sort of our theme in the second panel, which is, is there any money left to spend on social policy?

What we're going to do is have I think a very lively discussion with different perspectives on the government's fiscal situation and what should or should not be done about it. We have three wonderful people to do that.

Peter Orszag is the Joseph A. Pechman Senior Fellow in Economic Studies here at Brookings. He was a Special Assistant to the President for Economic Policy, that's President Clinton, for Economic Policy. He was a Senior Economist and Senior Adviser on the President's Council of Economic Advisers. He was also an Economic Adviser to the Russian government. I think the only way he could get advice to President Bush these days is to send it through Putin.

Then we will be followed up with Rudy Penner who is Senior Fellow at the Urban Institute and holds the R.J. and Frances Miller Chair in Public Policy. Previously he was the Managing Director of the Berents Group, a KPMG company. He was Director of the Congressional Budget Office from 1983 to 1987, one of the hardest jobs in Washington. He is the author of numerous books and pamphlets and articles on tax and spending policy. His most recent book, here's a good transition for you, is co-authored with Belle Sawhill and Timothy Taylor and it's called "Updating America's Social Contract."

Belle Sawhill would be our third speaker who is a Senior Fellow in Economic Studies at the

Brookings Institution where she co-directs the Welfare Reform and Beyond Initiative, and also directs the Brookings Roundtable on Children. Before joining Brookings she was a Senior Fellow at the Urban Institute. She was an Associate Director of the Office of Management and Budget from 1993 to 1995. She helped found and now serves as President of the National Campaign To Prevent Teen Pregnancy. One of those rare non-profit organizations that got founded and had all the social science numbers move in the right direction after the founding of the organization.

We're going to have this just a little bit more formal. We're going to have first Peter, and then Rudy Penner and then Belle Sawhill come and give brief presentations and then we will mix it up in discussion.

Peter, thank you very much.

MR. PETER R. ORSZAG: Thank you, E.J.

I'm going to talk about the budget situation in terms of social policy, but in the short term, the medium term and the long term. The short answer is in all three it's not particularly pretty.

In the short term we seem to be in a situation in which we're at war when it comes to social spending but peace when it comes to tax cuts. You see that manifesting itself in a variety of ways. Everything from the failure to reinstate the SCHIP funding that has now expired for states to education, etc. It's also playing out in the fiscal year 2003 numbers.

What you see in the appropriations levels that Senator Stevens has now signed onto is an increase in defense, homeland security and international affairs of $42 billion above inflation; and a decrease in domestic spending outside homeland security of $9 billion.

So often, and it's important to sort or break the domestic piece or the non-defense piece up into the homeland security and non-homeland security spending components. You can get a misleading picture of what's happening to spending in the area that we're supposed to focus in this morning if you just look at non-defense discretionary spending because that includes a substantial component of homeland security.

When you separate out the homeland security component you are looking at a decrease of about $9 billion after inflation in this upcoming fiscal year 2003 set of appropriations bills if we ever get off of the continuing resolutions.

Another little thing on the short-term outlook that we should remember is the little remarked upon change that the House leadership has put in place regarding control of appointments to the appropriations subcommittee chairs. Much more of the power, and we'll see how much of this is exercised, but much more of the power is now being centralized in the House leadership and that could mean that as the, inconsistent with what's happened in the past, that the appropriations bills actually are enforced and reductions in spending of say the $9 billion that I just mentioned actually do hold because the larger debate over the size of the deficit is something that the House leadership cares more about than each appropriation subcommittee chair individually cares about.

At the state level, that was at the federal level. At the state level the situation is also in auspicious in the short run. As you know, states are facing deficits of $40 to $50 billion and that's requiring significant adjustments both on the tax side and on the spending side. Just a couple of examples.

Medicaid eligibility was reduced or restricted in 25 states in fiscal year 2002 and/or 2003. One example, in Oklahoma for children aged one to five, eligibility for health insurance is being reduced from 185 percent of the poverty threshold to 133 percent.

In other areas, child care programs, for example, waiting lists have grown longer in 19 states and eligibility for services has been restricted in states varying from Indiana to Nebraska to New Mexico to West Virginia. Tennessee is cutting transportation assistance. Job skills training and substance abuse services. The list goes on and on. It's not surprising that given deficits of the size of $40 to $50 billion there are significant reductions in social spending that are occurring.

Turning to the medium run which I will call the ten-year outlook, the official federal numbers look relatively good. It looks like if you look at the official CBO forecast projections, it looks like we have a budget surplus of a trillion dollars over that ten year period, and that number actually may go up in January when CBO issues its new set of projections because we will be adding another year to the budget window, 2013, in which there is likely to be a large projected surplus at that time.

But it's very important to remember the assumptions that are built into those projections. When you adopt a series of what I consider to be more realistic or perhaps more insightful assumptions, the budget picture swings substantially.

So for example the official CBO projections assume that all of the tax cuts that are currently in place that are scheduled to expire -- not just the tax cuts from last year, but the regularly expiring tax provisions like the research and experimentation tax credit actually will expire.

If you instead assume that the tax cuts that are scheduled to expire don't, the difference is about a trillion dollars, so you get down to about zero right there.

The numbers also assume that there are about 39 million households that will be thrown onto the so-called alternative minimum tax by 2012. The alternative minimum tax was a system that was added in the late 1960s to ensure that high income tax payers paid at least some tax, but because alternative minimum tax is not indexed to inflation more and more households are being thrown onto it over time and this is a ticking time bomb in the tax projections. It's very very expensive to eliminate the AMT or even to attenuate this growth in the AMT over time.

If you try to address the AMT you're looking at costs of several hundred billion to as much as a trillion dollars over the next ten years for eliminating it altogether.

So now you're looking at instead of -- We started at a trillion. We get down to about zero by getting rid of the sunset. You're now looking at minus 500 to minus a trillion if you address the looming AMT problem. And then you say what about the surplus outside Social Security or outside Social Security and Medicare, you're looking at deficits of $3 to $4 trillion. That's before a Medicare prescription drug benefit and that's before making a more realistic assumption on discretionary spending. All of those numbers that I've just given you assume that discretionary spending fails to keep pace with population growth or the size of the economy. It's just fixed in real terms.

And by the way, if we fix discretionary spending in real terms but defense and homeland security spending goes way up, which it will, that means that all other spending is falling in real terms, even without taking into account the size of the population or the size of the economy.

So the bottom line is, given this budget outlook over the next ten years, it's hard to see how the picture for social spending is particularly auspicious. There will be lots of pressure on the budget from the tax cut, from the alternative minimum tax, from defense spending and homeland security spending. And by the way, these are the good years before the baby boomers retire.

So now let me turn to the long term where as we all know we're facing the coming retirement of the baby boomers. Social Security, Medicare and Medicaid will basically double as the share of GDP over the next 30 to 40 years. And the share of output, or the share of GDP that is consumed by those three programs alone will start to approach the average historical share for all government spending taken as a whole, including all other parts of government from the FBI to EPA to all the other things that government does. So you can see over the longer term that there is also a significant question about how the types of spending programs that are the focus of this panel would be financed.

One thing that I want to close on that note. Many of the plans that we see in Social Security, a little bit less so in Medicare because there aren't really any Medicare plans on the table other than ones that just cost more money, involve a change from what was the case say five or ten years ago.

Many of the plans now involve substantial amounts of revenue from the rest of the budget. That was true for the President's Commission. If all workers participated in the individual accounts it would require $2 to $3 trillion over 75 years. And it's true for the Shaw plan which has been introduced in the House which requires $4.5 trillion over the next 75 years. In fact given the real pain benefit adjustments that are in the President's plan, I think if anything there's going to be more movement towards a Shaw type approach which involves solving the Social Security system by basically pumping in money from the rest of the budget.

What that means is the perspective of the rest of the budget, you haven't done anything. You have not opened up any room for the other things that government does by solving the Social Security problem through general revenue transfers.

One of the big dangers in the Social Security debate is that, at least in the House is my impression, there's more movement towards that type of approach than towards the type of approach that involves programmatic changes that could actually free up resources in the rest of the budget.

I'll close on that.

MR. DIONNE: Thank you very much for that excellent case for prescription drug benefits, for tranquilizers for people who work in OMB. It's really helpful. [Laughter]

Incidentally, Ron Haskins will always tell you that I have a slightly distorted view of reality. I've noticed, I want to ask our organizers here. I noticed the break was supposed to come at the end of the second half rather than the first half. What I may do is just let us run through that time and then we will have no real break between the other two panels, and people will be free to get coffee as they wish.

Rudy Penner, thank you very much.

MR. RUDOLPH G. PENNER: The first thing that any discussant of the budget outlook must do is confess humility. Basically we don't know what the heck we're doing. [Laughter]

Forecasts of budget totals have always been bad but in recent years they've been absolutely god-awful. The change in the CBO's estimate of the 2002 budget has changed by a mere $300 billion over the 20 months beginning in January 2001. That's abstracting from any legislative changes at all. That was all because of economics and technical forecasting errors.

In the long run policy changes tend to make up for budget surprises but it does take many years. Consequently I think that forecasting errors will be more important to the budget balance over the next few years than any of the policy changes that we might be talking about today.

If in the next 20 months projections of the budget balance deteriorate by another $300 billion, the budget will appear to be in crisis and we'll be back into the situation of the 1980s and early '90s.

If on the other hand the budget balance improves by $300 billion it will again appear like it did in the late '90s, that we can have it all -- spending increases, tax cuts and so forth.

Now it's somewhat safer to look backwards, but given the revisions you see in economic statistics and changes from the way the budget is classified, I sometimes feel that we can't forecast the past any better than we forecast the future. But when the surplus emerged by complete surprise in 1998, budget discipline really went out the window. The congressional budget process began to erode, am erosion that accelerated when the Budget Enforcement Act was allowed to expire at the end of September.

On the spending side of the budget the biggest relative winners from the lack of discipline were farmers. The cost of the farm income stabilization sub-function of the budget rose over 300 percent between 1998 and 2000 before it started to go down in the last couple of years.

I'm not sure whether farm spending qualifies as social spending, though most farmers I know are pretty social. [Laughter] But if you look at other increases where spending really soared, some of it was clearly social. Spending on primary/secondary and vocational education rose over 60 percent in the four years ending in 2002. Health training and research also did extremely well. I'm not sure whether that's social or not. Another thing that went up a lot was the costs of conducting foreign policy as we secured our embassies abroad, and international development and assistance which is social abroad went up quite a bit as well, as did highways. Those two went up over 40 percent.

So in the four years, total real non-defense discretionary spending went up about six percent per years. And even if you extract the homeland security portion of that, it would only reduce the rate of growth by a percentage point or so. And that's after a period of incredible social stringency, or spending stringency in the discretionary side. IN the previous eight years real spending, discretionary domestic spending only went up about 1.5 percent a year.

Now if one believes Senator Stevens' $750 billion ceiling on total discretionary spending for 2003, it would bring civilian spending growth to a screeching halt, as Peter said. I guess I'm skeptical they might actually legislate that number, but if they do I would expect an enormous amount of cheating in the form of timing changes, advance appropriations, and very probably a supplemental of sometime next summer.

So there will be a social policy, and I think it will be evidenced by increase in spending. It may be inadvertent and it may be very confused as E.J. suggested.

The scariest budget thing going on recently is the explosion in Medicare and Medicaid costs. Together they've gone up about 20 percent in the last two years.

As we look ahead I think the most important decision on the spending side will involve a prescription drug program under Medicare.

It's common practice to talk about the cost of various programs in these ten-year cumulative amounts. One costs $150 billion, another costs $300 billion. I think we should change the first amendment to prohibit speech of that type because it's extraordinarily misleading.

The important thing to look at is the time profile of the costs, and almost every proposal has the costs rising like about 15 percent per year toward the end of the projection period. So almost no matter where you start, you end up with a huge compounded pop in the second decade of the program.

Without fundamental reform of Medicare a prescription drug program will clearly hasten the day of the train wreck that Peter so well described, and the nature I think of the resulting wreckage is not clear at all if we don't reform those programs.

Most likely to me they will ultimately squeeze out social programs, infrastructure spending, and maybe even defense. I would think, therefore, that liberals would be more eager to reform those programs, especially for the affluent elderly, than they seem to be.

Alternatively, of course, taxes could be raised to European levels, but I guess I would attach a very low probability to that outcome.

The final possibility is that the debt could explode, ultimately resulting in an economic disaster. Unfortunately I'd give some significant probability to that.

On that happy note, I'll stop.

MR. DIONNE: Thank you very very much.

With that proposal to amend the First Amendment, Rudy is now qualified to work in the Justice Department.

Belle Sawhill, thank you.

MS. ISABEL V. SAWHILL: The reason I think that this particular panel is so important today is because I do think social policy is increasingly going to be budget driven, so if we don't understand the budgetary context we can't deal with it.

I am painfully aware that when I was the Associate Director in OMB with responsibility for social programs during the first term of the Clinton Administration we worked very hard to reduce the deficits that we had had when we came into office. And of course the President had a lot of priorities in the social area and it was my job to try to find the money to pay for them. But I was asked to do that by finding cuts in other programs in order to fund our priorities. Having gone through that struggle you can imagine how painful it is now to see the kind of future budgetary picture that both Peter and Rudy have described.

Let me just then say that it seems to me what you have to conclude is that we are going to have probably some more tax cuts. We are probably going to have additional costs associated with fighting a war in Iraq. And we are only going to be able to pay for that right now by cutting other programs in a major way or by confronting staggering deficits in the future.

I think the question we should be asking given this scenario is, is there another way? Can we come up with a plan that helps the economy, protects social programs, pays for a war, and simultaneously avoids an absolute tide of red ink? And I think the answer at least in principle is yes and we should be talking about it.

On the economy the wisest course might be to leave this problem to the Federal Reserve. Countercyclical fiscal policy has a rather poor historical record and opens a Pandora's box to all sorts of foolishness. But some sort of stimulus package seems all but inevitable this year given the current state of the economy and the political itch to reduce taxes still more than we did last year. The question is what's that stimulus tax going to look like? Who's it going to help? And how much will it add to longer term budgetary problems?

One option would be to accelerate the already enacted but not yet implemented tax cuts targeted on working and middle class families. This would mean immediately increasing the child tax credit to $1,000 a year and making it partially refundable, and it would also mean expanding the ten percent tax bracket.

Another option is a much more temporary tax cut targeted to these same families. An example would be a payroll tax holiday along the lines suggested by Senator John Kerry.

Any stimulus package, as was noted earlier, could include assistance for hard-pressed state government. We may not think that's in the political cards right now but I agree with Tom Mann's comments that they are being asked to take on more responsibility, the federal governments hands are not clean in this process, and they desperately need resources.

This assistance could take the form of a higher federal match in the Medicaid program, or expanded assistance for child care, social services, education, transportation and homeland security.

One could conceivably tie this to a requirement that states build more adequate reserves or rainy-day funds in the future because one of the reasons they are in such desperate straits right now is because they didn't save their money when the sun was shining.

As Alice Rivlin notes in a new Brookings policy brief which will be forthcoming shortly and drafts of it are available out in the hall. States have already had to cut Medicaid, child care, job training and other programs, particularly affecting low income families in order to fill yawning budget gaps. Peter talked about that as well.

The economic point here, of course, is if there are various efforts to balance their budget actually are working to impede economic recovery.

All of these stimulus options don't help much with the longer-term budgetary problems that both Peter and Rudy alluded to. In fact these options add to deficits in the short run, and depending on how they're structured could add to the long-term deficit as well.

To deal with the longer run fiscal situation, many people believe we should freeze all or a portion of the 2001 tax cut that has not yet gone into effect. This entails recognizing that the very large surpluses once predicted were never real and have now disappeared, partly because of a faltering economy but also because of the tax cut itself. It also entails recognizing that a sense of fairness matters, that a tax cut that provides 40 percent of its benefits to people who earn more than $200,000 a year is an outrage.

The good news is that these cuts have been promised but not yet delivered and it's not too late to rectify the mistake.

But canceling a portion of the tax cut should not be an excuse for letting spending get out of hand. A tax freeze could be combined with a non-defense spending freeze of the sort that Rudy talked about having prevailed to some extent when the Budget Enforcement Act was in place.

This spending freeze could allow for increases in prices and in the size of the population, but still force some tough budgetary tradeoffs between programs of the sort that I talked about our having to have faced in the early Clinton years.

Finally, we could ask everyone to contribute something towards the cost of the war on terrorism. After 9/11 patriotism was at record levels after all, but no one took the opportunity to ask what we could do for our country. Once the economy recovers more fully, all Americans could be enrolled in the fight and asked to contribute by paying say a five percent surtax. This is what we did during the Vietnam War. In 1967 President Johnson proposed a ten percent surtax which was enacted after a lot of initial congressional resistance in June of 1968. It was levied on both personal and corporate incomes, was a flat percentage or add-on to people's existing tax liability so it didn't change the structure, and remained in effect for several years. Any new surtax should similarly be temporary and the proceeds could even be placed in a trust fund and earmarked for expenses associated with any war in Iraq, with homeland security, and related expenses associated with the threat of terrorism.

The costs of such a war are highly uncertain but several analysts have now come up with figures suggesting that a war with Iraq could cost as little as $50 billion or as much as $600 billion over the next decade, depending upon whether and how long we have to occupy Iraq and how much our allies contribute to the effort.

To sum up. The kind of plan I'm suggesting that would help the economy recover in the short run, lead to a less unequal distribution of after-tax income by canceling the regressive cuts enacted last year and force some tough budgetary tradeoffs by freezing non-defense spending at current levels, and assure that the war on terrorism including homeland security was adequately funded. It would also reduce long term deficits and help to grow the economy by freeing up savings for private investment. It's major components, just to reiterate and summarize, would be a short-run stimulus package, a freeze on all or most of last year's tax cut not yet implemented, a freeze on non-defense spending with provisions for inflation and population growth, help for struggling state governments, and a temporary surtax on income to pay for the war on terrorism.

Do I think we will do these things? No way in our current political environment. [Laughter] Should we be talking about them? Yes. It could influence the future political environment.

MR. DIONNE: Thank you very much, Belle.

Read Belle's lips, we need new taxes. [Laughter]

I'd like to, before we get to taxes it seems to me one of the central issues here is the projections of future deficits. And Rudy you might talk about this a little bit more and I'd like Peter to respond. There seems to be a movement among conservatives to say these projections are really no good so we shouldn't have to worry about the long-term surpluses. It's sort of like Tony, when you're behind in the game you turn off the scoreboard. But perhaps that's unfair of me.

What is this argument about? What are the sort of substantive underpinnings of it? Because it does obviously serve an important policy and political purpose for many of the people who are making it.

MR. PENNER: The projections really are no good. That has to be accepted. But they're all we have and that's the big problem.

I think the only way to confront this enormous uncertainty is that we should be encouraging the Congress to debate a little bit more the implications of their actions if the baseline turns out to be very much worse or very much better than we expect.

The problem is the Congress really does always behave as though these budget projections are point estimates that they assess with certainty. It's very frustrating to deal with that, but that's where we at.

I think we should stop projecting the baselines for ten years for the purposes of formulating a budget resolution. You can score policies over ten years if you want, but the projections of the budget balance which is the focus of the resolution are essentially noise once you get beyond six or seven years.

MR. DIONNE: What has made the projections worse in recent years?

MR. PENNER: The difficulty mainly in forecasting revenues. We had an enormous surge in revenues relative to GDP in the late '90s which brought us a budget surplus by total surprise. Now that was related to capital gains but I think more fundamentally to how well the very very rich did during that period.

We don't have the data to judge why there was a reversal. Only a small part of it can possibly be capital gains My on suspicion is that the rich suffered more in this recession than did other people. So if we want budget revenues we should pray for the rich. [Laughter]

MR. DIONNE: Peter, are you praying for the rich?

MR. ORSZAG: Let me say a couple of things on uncertainty. I certainly agree that uncertainty means that we should treat the budget projections with caution. However I would strongly warn against adopting say a five-year budget window and then making policy changes outside that five-year budget window. That would lead to very very problematic policies and it is the type of approach that we have seen in certain recent contexts.

So if we want to say that uncertainty means that we shouldn't be doing budget protection in the budget resolution for ten years, but rather five years, then let's also have a set of rules in both the House and Senate that means that you can't make policy changes outside of that window and thereby hide the cost.

In the Senate there is the Byrd Rule that basically can be invoked to ensure that if there are budgetary costs outside the budget window you need 60 votes. One of the things that we'll actually see playing out this year is various different ways in which that rule is invoked, or not. For example my prediction is that it will be much more difficult to make the state tax repeal permanent if the Senate still uses a ten year budget window for its resolutions than it will be to just extend the repeal for two extra years or three extra hears -- 2011, 2012, and 2013. That will likely only require 50 motes so it's very difficult to see how that would be stopped.

The second thing I'd want to say about uncertainty is the right response to not just the projection of uncertainty but the underlying real uncertainty in the budget outlook is not to ignore it, but if anything it would tend to lead to more conservative, and by conservative I mean more policies-oriented toward fiscal discipline than in the absence of budgetary relief. It's true that the situation may be better than we think or worse than we think, but if what we gain when the situation is better than we think is not as much as what we lose when the situation is worse than we think, then the uncertainty could be tilting us towards being more careful or more conservative, not saying everything is fine and let's go have a great time.

MR. DIONNE: Belle, do you have a view on this?

By the way, Rudy has come up with one of is truly innovative ideas today when he said pray for the rich. He finally figured out a way to include the rich under the President's faith-based initiative. [Laughter]

MS. SAWHILL: I think one of the reasons that there's so much uncertainty is because it's very hard to predict the economy and the huge swings and the projections depending on what happens to the economy. But I think you can play a very interesting what-if game in terms of what the cost of various policies are.

For example there are two senators who recently asked CBO to do an analysis based on various assumptions about spending. And one of the assumptions that CBO was asked to make is suppose that spending increases by the same rate over the next ten years as it did from 1998 to 2002. What would the deficit in 2012 look like under that simple assumption and a few others that related to the expiring tax provisions that Peter talked about.

The answer is that in that one year, 2012, the annual deficit in that year in that what-if scenario would be about half a trillion dollars, and even more than that if you exclude the Social Security monies. It's $900 billion if you exclude Social Security. In that one year alone.

So if we go back to the political discussion that we had on the first panel that's been alluded to here as well and we think that Congress isn't going to be able to restrain itself, and we're going to have spending increases that look like what they've looked like recently, that's a more realistic scenario.

So it doesn't say a scenario that's going to happen, but it says if we do these things this is the fiscal implication.

MR. DIONNE: Is it possible to be a little -- Peter said it well when he said we're at war when it comes to social spending and at peace when it comes to tax cuts. It does seem to be the case that the Administration when spending comes along, including homeland security, says ah, we have a deficit problem, let's cut there. And yet the tax cuts haven't entered into that discussion at all. Can somebody enlighten me on why this is the case?

MR. ORSZAG: Not only that, but remember that many of the stimulus ideas that are currently being floated, apparently from Administration sources, would be incredibly expensive. Excluding dividends from individual taxation, for example, which is one of the ideas being floated, it would cost between, it would reduce revenue, sorry, by between $250 and $500 billion over ten years. If you include interest costs you're up to $300 to $700 billion.

We're talking prescription drug benefit levels and here's, this is on top of last year's tax cut.

MR. PENNER: There's a very important principle you're totally missing, and that is that good conservatives believe the way to squeeze down the size of government is to cut off the revenue, to starve it. That's the difference in philosophy here.

MR. DIONNE: That is fine if you don't have very substantial increases in both military and homeland security spending which the President supports. In other words if this were actually a libertarian Administration -- if [Bilnes Canon] were running economic policy that might work, without producing big deficits.

MR. PENNER: I very much disagree with Belle. When you have a surge in spending and most of it is military, and by the way very little of it is related to September 11th. But if you do have a surge the last thing you want to do is finance it with a tax increase. Economic theory tells you there are huge welfare gains from keeping tax rates relatively constant over time.

The question really is what happens to domestic spending in the long run. And maybe the surge in military spending will continue, but that is not the Administration's proposal.

MR. ORSZAG: I think one of the things that's going on here, and you see this in the Administration, at least in the previous team and we'll see what really happens with the new team, is the argument that basically deficits don't matter. They don't affect interest rates, they don't really affect anything so there's no cost to -- plus we get the economic growth that the tax cuts bring.

What that really leaves out of the picture, and we can talk about deficits and interest rates because I think the evidence there is not as ambiguous as the Administration thinking may seem, but the key point is that regardless of whether econometricians can measure a relationship between deficits and interest rates, increased deficits reduce national savings. And reduced national savings reduces future income.

The argument that high taxes kills growth, there's another side to this which is high deficits, if we want to use that inflammatory rhetoric, also kill growth. They reduce future living standards. That part of the equation just is not given much weight, at least from what I can see in the Administration.

MR. PENNER: I agree with Peter about the theory of deficits, but I think one of the problems here may be that even with the kind of deficit numbers that Belle cited we're a long way from the kind of deficits relative to GDP that we had in the 1980s and even in the early '90s. So I think that's part of the problem of invoking any budget.

An important issue that we really haven't discussed much and is not in the public discussion, I think the total collapse of the congressional budget process is a very serious matter. It's very hard to get anybody interested in it.

MR. ORSZAG: If I could just say one thing on the size of the deficit quickly which is thank goodness that there was some fiscal discipline at least through a good part of the 1990s so that when September 11th hit and when the recession hit we wind up with deficits of $150 to $200 billion projected out instead of $400 to $500 billion projected out.

So I don't think that the arguments in favor of fiscal discipline have in any way been attenuated, although I agree that their political saliency may be weaker now because the deficits just aren't as large.

MR. PENNER: That was all Belle's work at OMB. [Laughter]

MR. DIONNE: I wanted to ask about the Sawhill Growth and Balanced Budget Act of -- [Laughter]

It's a problem of how you can have the combination of short-term stimulus and the tax for the long run to keep the budget in balance over the long run. How does that work? I think there is an essential contradiction here which I'm sure you can resolve between these two goals.

MS. SAWHILL: For economic reasons you don't want to be raising taxes or cutting spending

a lot while you've got unemployment rates around six percent. Although as I suggested, I think fiscal policy is not these days in a lot of favor as a counter-cyclical instrument. But still you don't want to exacerbate our current sluggishness in the economy by moving in the wrong direction in the short term. But that's a very short-term issue. You could conceivably reduce some taxes in the short run while raising them over a ten-year period, let's say, so that on net the ten-year budgetary costs were in the right direction. In other words reduced the projected deficit rather than increasing it. But it's a matter of do freezing the part of the tax that hasn't gone into effect yet, will that be enough to pay for the shorter run stimulus? Some of the plans that have been put forward by some Democrats when looked at using the Brookings
Urban Institute Tax Policy Center model still show, as Peter has pointed out to me, net cost over this ten-year period. So they don't contribute unless they're structured correctly and carefully to fiscal discipline over the longer run, but they can. And you certainly want to backload the restraint and frontload the stimulus. That's the whole point.

MR. ORSZAG: There's enormous confusion in the public discussion right now between what I would call a stimulus package and what I would call a growth package, and the Administration uses both these terms. Some of the things you would do for economic growth would be actually anti-stimulus in the short run.

MR. DIONNE: What would be an example of that?

MR. ORSZAG: If they make the 30 percent expensing permanent. Making it temporary will probably move a lot of investment into 2004 whereas if you make it permanent the surge in investment because of timing considerations probably disappear.

QUESTION: Van [inaudible].

The discussion of changing taxes or revenues as a policy matter seems to have been couched entirely in political terms. Rudy said that he didn't see politically -- I think he probably would reject it on policy grounds as well, but he didn't see politically that we would be going to European tax rates.

I guess my question is, since we're playing sort of never-never land about how policies might change, is there a substantive economic reason that's compelling that would suggest that taking tax rates back to where they were in the mid 1990s before the big tax cut would be bad for the economy? In other words, are we not discussing that in this national conversation simply for political reasons? Or are there serious economic reasons?

We're all aware that there are dead weight losses to taxes and all of that. On the other hand the economy seemed to do pretty well under those dead weight losses in the 1990s.

MR. PENNER: I think the important thing if you're going to raise taxes is how you raise them. And I think people are too obsessed with the notion of reversing the Bush tax cuts which are politically implausible anyway. So if I can be as politically implausible as Belle was, I think that you want to talk about a base broadening and there are all sorts of easy things you can do politically like reduce the subsidies to homeowners -- [Laughter] Things like that which would be really pro-growth and certainly less harmful economically than raising marginal tax credits.

MR. ORSZAG: I'd just add two things. First on the base broadening. While economists do get, that's the sort of natural default for economists to say let's broaden the base and reduce the tax rate. It is important to realize that the tradeoffs that we faced in 1986 were different than what we face now. There were more tax shelters, there was more opportunity for broadening the base then effectively than there is, and that allowed more reduction in the rate as a tradeoff. So I think if anything it would be harder.

Another way of putting it is we're maybe not down to the bare minimum, I hope that's not the case, but we've reduced the amount of tax expenditures to the sort of things that are really popular politically, and it's harder to do the kind of '86 reform, again, than it was then.

On the evidence of the economic benefits or costs associated with changing marginal tax rates, you could think about that as just the reversal of the 2001 tax cut, and what have people found about what the impact is on future economic activity from the reduced marginal tax rate, and if you want to run it in reverse, a hither marginal tax rate.

The key thing is what you assume about what would have happened to that levy. If you assume that the revenue would have been saved then there are a bunch of studies that buy either very little effect or a negative effect because the improved incentives from reductions in marginal tax rates are outweighed by the costs associated with the reduction in national savings. So it again comes back to this question of how much of the money would have been spent anyway if we didn't have the tax cuts. I'm somewhat more auspicious, I'm inferring from Rudy's comments that we could actually save a good chunk of the money that was instead devoted to tax cuts, or that we could save more of the money that would be raised through slight increases in marginal tax rates, but that's effectively a political judgment which is why it comes down to politics.

MS. SAWHILL: I think that Van's question raises the whole issue of semantics in this political debate that we're going to have. If canceling the portions of the tax cut that haven't happened yet is called raising taxes which is what Republicans will call it, the public may react one way. If it's called not reducing taxes further, which is what Democrats will say, it has another meaning.

We had a little conversation amongst the panelists before we came in here in which virtually everyone around the table agreed that we are going to make the 2001 tax cuts permanent, not just fail to cancel the out-year portion. That costs and estimated, if you can believe such projections, $4 trillion in the ten years beginning in 2012 roughly speaking. That's big money.

My question is how do we pay for a war, meaning a war on terrorism, at the same time that we're cutting taxes this much, without absolutely decimating everything else that government does.

MR. DIONNE: One deficit that's measurable is the time deficit and we're starting to eat into the other panel's. Two things. In good Washington fashion we will extend the time at the end. We'll just make up the extra minutes. And I just want to see any hands who have an urgent desire to jump into this discussion now because I'd like to bring in a couple of more voices if you'd like to join and then I'll let Peter and the panel conclude if that's okay with you. You can start on this point and then move on to something else.

I don't want to discourage anybody. Okay.

Peter, why don't we just have final comments here.

MR. ORSZAG: I guess this wasn't necessarily a broad concluding comment but rather just to follow up on Belle's discussion.

It strikes me, and this may be wrong, but it strikes me that the debate inside the Beltway is so much about freezing this component of the tax cut or that component of the tax cut. The Democrats trying very hard to preserve the full tax cut burden. Ninety percent of the population or 92 percent of the population or whatever. I don't think most of those people even realize that there are more tax cuts in the pipeline. Democrats are fighting very hard for an increase in the child credit which is scheduled to go up to $1,000. If you went out, I've tried doing this with real people outside of Washington, if you went out and asked do you realize that the child credit's going to go up from $600 to $1,000? I have not yet received one affirmative answer that people actually realized that that increase was in the pipeline. Which I think is one of the reasons why this debate gets so confused. Democrats go out and say we want to freeze the tax cuts but only for the top two or three percent, and people say freeze the tax cut? What are you talking about? I didn't know I was getting more tax cut. It leads to concerns about what's happening today.

I think it's at least, and again we're coming back to politics, but I would love for some Democrat or moderate Republican to step up and say no new tax cuts until we win the war on terrorism period. And that means everybody. That doesn't mean just the top one or two percent, that means everybody. We are fighting a war, we shouldn't be pretending that we're at war when it comes to spending but peace when it comes to tax cuts. We're fighting a war. That means everyone needs to pitch in. Shared sacrifice. Everyone gets their full tax cut that's already in effect and no one gets any more until we win the war on terrorism, period. Very hard line. I doubt we'll hear anyone say that.

MR. DIONNE: Rudy will now endorse this. [Laughter]

MR. PENNER: I'd like to change the subject.

I'd like to return to the big gorilla in the room that we haven't talked about enough and that is this long run outlook which makes all these other issues pale by comparison quantitatively. But with current policy, with no prescription drug program, we do have the sum of Medicaid, Medicare and Social Security projected to rise by some six percentage points of the GDP by 2030. That implies a one-third or so increase in the size of the federal government. That is the real issue here. All of the other things just affect the timing of when the train wreck occurs, whether we have an extension of the tax cut or not. And so on.

There really has to be much more focus on this. As Peter said, we're hardly debating Medicare at all which makes the essence of the problem much more serious than Social Security, and somehow or another we've got to get that debate going.

MR. DIONNE: Through absolutely no planning we are having perfect transitional comments for the next panel. Thank you very much for that.

Belle, for closing thoughts.

MS. SAWHILL: Well, I like the slogan no new tax cuts until we win the war on terrorism, but I also want to point out that just as Peter has discovered, that people out there in the world don't understand this discussion that we have inside the Beltway. I am struck by how little people have glommed onto the fact that the tax cuts that haven't gone into effect yet are so heavily tilted towards the wealthy. I mean we've talked about that ad infinitum here in Washington. I think one of the reasons is because when you say to people 40 percent is going to the top one percent they all say to themselves, well I'm in the top one percent. Or I'm going to be in as soon as I make my next job move or my next stock market move. So there's this feeling in this country that that's not a major issue.

So I have decided that we've got to talk about this in dollar terms as a small change in the conversation here, and talk about people earning more than $200,000 a year. Then I think it has a little different resonance. But that's a footnote.

I look forward to the more detailed discussion of the next panel. I want to hear from them where they think they're going to get the money to pay for anything.

MR. DIONNE: To paraphrase Peter, I want to thank these unreal people from inside Washington for their very thoughtful comments. [Laughter]

If we could have the next panel come up and we could just roll very quickly into the next discussion that would be helpful.

Thank you very very much.

[Applause]

MR. DIONNE: Thank you everyone for letting us make this quick transition.

I guess Henry, if I could start with you because Rudy's comments lead right straight to two of your many areas of expertise -- Social Security and Medicare. Can you just talk about the outlook on those and what you're thinking about?

MR. HENRY J. AARON: Let me return to some points that Tom Mann and Bill Frenzel and others discussed at the first session.

The initial question is what the President really needs in order to win reelection. I think he needs two things -- a victory or a success in the Middle East, and an economy that has resumed growth and ideally has returned to full employment.

Those are necessary and I think sufficient conditions for him to be reelected. To be sure, he also needs to be able credibly to go to the American public and say that he is not ignored, has dealt in some substantive way with domestic social concerns.

The practical question for this panel is what it takes to fulfill that third requirement.

In my opinion, along with Tom, it does not require presenting a full-blown Social Security proposal and fighting that war. In fact if the White House political operatives who I think all of us on both sides of the aisle recognize as highly capable individuals look to history, they will move ahead very cautiously. They will remember President Nixon came into office at a time when the national sentiment was strong for welfare reform. He presented a proposal. It met initial strong approval from the public and it went down in planes. They will remember Jimmy Carter and welfare reform, ditto on all scores. And most recently they will recall the experience of Bill Clinton with health insurance reform.

Again, the prevailing national sentiment was that action was needed, initial reviews of the plan when announced were favorable, and the outcome was devastating from the standpoint of the Administration.

Why? Because when a detailed proposal comes from the White House then and only then is the point at which serious debate really begins. We have not, noisy debate to the contrary notwithstanding, in my opinion, yet begun to have a serious debate on Social Security reform, and we will not do so until and unless President Bush tables a specific proposal that can then be subjected to detailed analysis, honest criticism and political demagoguery and it will face all of those things.

If the President sees the future as one in which a strong economy and success internationally is sufficient for reelection, indeed not just for reelection but for a big victory, I think he will conclude that Social Security should wait. Health insurance is a different matter. Something I believe will be proposed by the Administration on prescription drugs and with control of both houses of Congress, the president is quite likely to succeed.

The difficult challenge with respect both to health care and to Social Security is that you can find nobody anywhere in the nation who believes that Medicare is excessively generous today, that benefits are too fat, and with good reason. Medicare is a very parsimonious health insurance program.

You can find almost nobody who says that the elderly are collecting too much in the way of pensions and ought to collect less. From the left to as far right as Senator Phil Gramm, you have proposals emanating from Congress that would actually increase the pension amount that the elderly would take home and they call this Social Security reform.

What these constraints, what these views of the generosity of Medicare and Social Security mean is that closing the deficits in these programs is going to inevitably exacerbate, not alleviate, the problem that Rudy Penner and Belle Sawhill and Peter Orszag outlined in the previous session.

MR. DIONNE: Thank you so much. I was thinking of the ideal Brookings panel on Social Security. Our first speaker will do analysis, our second honest criticism, and our third speaker will do political demagoguery. We can have a nice balanced discussion. [Laughter]

Ron Haskins you have just spent a good deal of time inside the Administration working especially on welfare reform. Could you give us your perspective on what's coming? And in particular on welfare reform reauthorization. Why didn't it happen in the last Congress and how will that affect what's going to happen in the next Congress?

MR. RON HASKINS: I noticed how as soon as you talked about political demagoguery you turned and said Ron. [Laughter]

MR. TOM LOVELESS: No, analysis was actually the first on the list. I'll take the demagoguery.

MR. HASKINS: I have a feeling that the issues that a lot of people in this room really care about has hardly come in for any discussion here probably because they're not big mega issues, that you can't figure out how to spend $3 trillion on TANF. So I think what is likely to happen with those issues will be somewhat unaffected by the budget deficit.

I think one thing to say about the Administration in response to your question is that the Administration has a very clear, coherent domestic policy. The clear coherent domestic policy can be easily summarized. Work, marriage and faith. I am glad nobody chuckled, but I've been in many situations where people do chuckle when you say that. Oh, that's not a social policy. But the American public thinks it's a social public and I think I would make a strong argument, and I think Bill Galston might even agree since he was one of the movers of welfare reform in the Clinton Administration, and Democrats and Republicans agreed that there was too much welfare and not enough work. As a result of that we changed the system -- didn't necessarily agree with every particular of the changes, but we had a big bipartisan vote and we really truly changed the system. As a result of that many more people work and welfare payments went down. We know this very clearly from the Census Bureau today. There's no question about it. These families, single moms who get most of the smaller welfare programs, the entitlements for foodstamps and so forth, their benefits went down and their earnings went up and they were better off roughly by 20 percent. So here's a solution that does not necessarily require big budget expenditures.

I would go on to point out that the President has proposed several additional policies that would move this agenda further. The President's reforms in child support enforcement that would wind up giving more money to families, enjoys huge bipartisan support, would make those families better off, maybe 280,000 or so of those families.

The President already in a little noted victory changed the foodstamp program in several important ways to give the states much more control so that working families would be more likely to get foodstamps. I think this is the single most important policy to put cash in the hands of working, low income families, because are less welfare eligible for about $2,000 in foodstamps and as near as we can tell about half of them don't get it.

So if the states use those reforms that cost about a billion dollars over five years in the Farm Bill, more of these families will get foodstamps and they'll be even better off than they already are.

Now as to TANF. It's a simple explanation why it didn't pass. It never came to a vote in the Senate. We have an unusual form of government that to get a bill you have to pass the House, you have to pass the Senate, and the President has to sign it.

Now you can make lots of abstract arguments about why it didn't come to a vote in the Senate, but I think I can counter almost all of them with this simple consideration. There were three Republicans on the bill coming out of committee. We estimated all year long that there were ten Republicans that would have voted for the bill if it had come to the floor, so Daschle might not even have had a 60-vote problem. And on day care votes we would have lost even more than that.

So put that together and figure out why the bill didn't come to the floor. That's why it didn't pass. So I agree with Frenzel. The bill will come to the floor pretty quickly in the House. It will be roughly the same bill. Maybe there will be some minor adjustments especially maybe on waiver language. And the bill will pass the House. I predict there will be a few more Democrats that will sign on this time. It will go to the Senate. And there it will encounter roughly the same problems it had before.

So the key is to drive it through the Senate, get it to the floor, get a bill that will not be very much to the Administration's liking. It will be a little bit more to the right than the bill would have been last year. Then go to conference and bring something out of conference that is more conservative than the Senate bill and send it back to both houses and basically say to people in the Senate, do you want to vote against welfare reform? Go ahead. I think that will get us a bill. It depends on the schedule and everything, but this could be done in six or eight months. But it certainly will be done by next fall. I think there's no question of that.

MR. DIONNE: I want to get back to that, for you to describe that in more detail. I was going to go to Tom next but I couldn't resist going straight from that to Bill Galston because I wanted to ask him will Democrats come out against work, marriage and faith -- [Laughter] And more particularly, if you could talk about the strategic choices facing the Administration in areas of social policy and the choices facing Democrats.

MR. AARON: Let me respond by talking about my dark vision of the rest of this decade. To add one more dark vision to the ones that have already been put on the table.

I think we can stipulate for the remainder of this decade a permanently higher base of defense and security spending than we enjoyed, if that's the right verb, in the 1990s. Even setting aside the imponderable expenses of a war and subsequent occupation of Iraq.

In that context I make the following two predictions with great confidence. Prediction one, which is principally addressed to my Republican friends. If the Sawhill plan is not enacted and instead the tax cuts and others not yet on the table but soon to be there are made permanent, there will be a relentless squeeze on discretionary social spending, the topic of this morning's forum as far as the eye can see.

Prediction number two. If the fundamental building blocks of the social insurance state are left unreformed and are instead expanded there will also be a relentless squeeze on discretionary social spending for the remainder of this decade. If both of those things happen, and I think that would be the smart bet, then I would predict either unprecedented pressure on discretionary social programs for the remainder of the decade or very rapidly rising deficits or some combination of the two.

Now here is my inference from this analysis. This is not just an imaginary garden, to quote the poetess Maryann Moore, it has real toads in it. In particular, this decade, the first decade of the 21st Century will be a very bad time to be a low wage worker in America if this scenario comes to pass. Those are the folks whose prospects will be so centrally affected by our inability to do anything significant about pre-K programs, about fully funding the education bill which is the centerpiece of the President's domestic agenda to date in my judgment, child care, health care for low income children, etc. We've already heard from Peter about rollbacks at the state level. We haven't seen anything yet if this scenario unfolds.

A second inference from this. I think there will be a tendency to shift social debate, policy debate, towards symbolic issues and towards the courts. And so I think there will be much more focus on the sorts of social policy issues that can be litigated, whether we're talking about affirmative action and the Bacce decision or gay rights and the Bowers decision or you name it.

Finally, with regard to the faith-based initiatives, and here I agree there will be some discussion in 2003. There are actually three camps on this issue. There are the House conservatives who have already stated what they think ought to be in the bill and I believe that their first move early in 2003 will be to restate what they think ought to be in the bill -- a dramatic expansion of charitable choice and allowing faith-based institutions to use public funds to, as liberals would put it, discriminate on the basis of religious identity.

The liberals, and this is an unwritten part of the story, have never accepted the proposition enunciated in Title 7 of the Civil Rights act that faith-based institutions ought to be allowed to discriminate on the basis of faith in employment decisions regardless of whether those jobs are federally funded or not, and a number of them tried to use this discussion in the most recent Congress to push forward that point of view.

Then you have the center. People, principally moderate Democrats in the Senate led by Joe Lieberman who genuinely wanted a bill and were looking for partners in the Administration as John [Biulio] has now informed us, who were willing to meet them halfway.

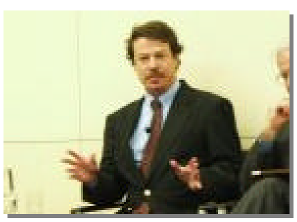
So the fundamental question it seems to me with regard to the faith-based institution is whether the Administration will tack towards the center definitively and tell the red hots in the House that they're not going to get their way on this, in which case the Administration will get a bill sooner rather than later; or whether they're going to decide that this is going to be their principal Exhibit A for base politics in 2003, in which case they're not going to get a bill in my opinion.

MR. DIONNE: Thank you for that analysis. Anyone who doubts that there are dark pictures here, I've been keeping track, the animals who have come up so far are worms, mice and toads. God save us all. [Laughter]

Tom, will you save us out of this darkness? Basically how will education remain a major priority for the Bush Administration? Will there be any new initiatives on the horizon? Any new spending on the horizon?

MR. LOVELESS: I can paint a slightly brighter picture because --

MR. HASKINS: Get out of here. [Laughter]



MR. LOVELESS: The reason for that is education at the federal level has never been dependent upon a large budgetary outlay. The federal government spending on education remains small today, about eight percent, kindergarten through 12th grade spending. Historically it's never achieved ten percent. During the Great Society, the wonderful programs that were started, it was in the four to five percent range. So education is a domestic priority that is largely shouldered by state and local governments.

So as Bill was talking about symbolic politics and symbolic action, at the federal level a lot of education activity is symbolic in nature. Somebody else has to pay the bill.

As far as the Administration goes, No Child Left Behind, they think they have a winner. Basically what you see is what you get. The Bush Administration was able to neutralize what historically has been a very strong policy arena for Democrats, and that is the field of education. Basically people who were most concerned about education broke 50/50 in the election and the Bush folks think they can pull that off again when the President runs for reelection. So they want to be talking about No Child Left Behind in 2004. They'd like to be talking about No Child Left Behind in 2008. They think it's a popular bill and they think it's an accomplishment they can crow about.

With that said, I think the rest of what you're going to see out of certainly the Bush Administration over the next two years will be emBelleishments on No Child Left Behind. There are a couple of implementation concerns that are beginning to bubble up now from local districts and from states. One is just the cost of implementing the testing requirement of the Act. Almost all the states had testing but they didn't have it annually in grades three through eight. So what you're finding is that states -- let's say they tested their fourth graders, they tested their eighth graders, now they have to test every year grades three through eight. It costs money to implement this kind of testing. The states are beginning to complain that they want more help from the federal government on implementing that.

A second requirement in the Act is that teachers, all teachers by the 2005-2006 school year have to be fully qualified, are the words. The regs have come out that fully qualified means essentially you have to have some kind of teaching credential that you receive either through an alternative credential program or through a traditional one. This is going to be very hard to implement. A lot of states, especially tough to staff areas, urban districts -- There are some urban districts that have fewer than 50 percent of their teachers in certain subjects that meet that fully qualified stipulation. So the states and localities are beginning to say we need help in terms of teacher training, we need help in terms of certified teachers. And the problems, there's also a problem with para-professionals that is very similar to that.

So that's where I think we'll see future action, will be minor tinkering with No Child Left Behind, but that's going to be the brain work for the Administration's future education effort.

MR. DIONNE: Thank you very much.

Henry had a dissent from part of what Bill [inaudible] to bring up. Without putting you on the spot, Margie, I would love you to ask Ron a question about where welfare reform is going to go. IF we can get Margie Waller, our own -- I can say proudly -- Margie Waller a microphone.

But Henry, why don't you have an exchange with Bill on the point you whispered in my ear.

MR. AARON: I wanted to comment on the issue of whether entitlement reform will make things easier or harder for social spending for the non-elderly over the next decade. The key part of what I'm going to say refers to the period.

I want to suggest that the issue of social reform has no potential to improve the prospects you're describing over the next decade.

Take Social Security first of all. The President made clear that everybody 55 or older would be grandfathered, and by the time Congress gets through with it even more people than that I suspect, will be protected. We're not going to cut benefits for those nearing retirement or those currently retired. Elected officials know to do so the shortest way to an early retirement of their own and are therefore loathe to do it.

From the standpoint of freeing up budget resources over the next decade or so therefore, Social Security simply has nothing to do with the availability of budget resources.

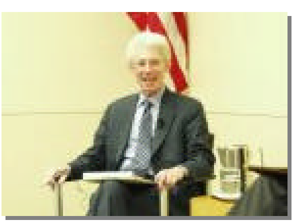
Rudy Penner was just right when he referred to a horizon stretching out to 2030. Basically the problem of Social Security financing comes in the second half of that 30-year period, not in the first half.

With respect to Medicare, the best thing that could happen to the availability of resources for social spending for the non-elderly would be if we did nothing at all because any plausible reform of Medicare, any plausible tinkering with that program is going to increase costs. Prescription drugs, long term care, cost sharing which in Medicare is exorbitant for significant minorities of Medicare recipients.

If we're to do anything to deal with these problems, it is going to increase budgetary spending, not reduce it. Yes, we can find ways perhaps of saving some money through more efficient delivery of health care, but hoping to achieve savings in Medicare through increased efficiency has just about as good a prospect as reducing defense spending through increased efficiency. The record is poor, it's not going to happen.

So from the standpoint of entitlements, don't look for relief.

MR. DIONNE: Bill, do you have a reply to that?



MR. GALSTON: Let me just quote myself -- [Laughter] -- to indicate that Henry, Aaron and I, I think are agreeing vehemently. What I said, and I will just repeat it verbatim, is that if the basic building block: of the social insurance states are left unreformed and are instead expanded, right, and that was principally a reference to Medicare along all the dimensions that Henry just listed, then I said that will contribute to a relentless squeeze on social spending.

I think Henry and I would agree that for example if there is a prescription drug benefit in the current Medicare program, if we then went on to do something about long term care and the other things he mentioned, however meritorious each one of those may be on its merit, those changes can hardly be without consequence for domestic social spending. And given the fact other than No Child Left Behind, the single most important thing in social programs that's likely to happen this year because Republicans promised it in the most recent election, is a prescription drug benefit. That must happen or it will be seen by the American public as a breach of faith, and not a small one.

Then I think that my case stands. I see no way to evade the basic arithmetic and political logic of the situation. However little money there is right now for discretionary social spending in the years 2009 and 2010 there will be less.

MR. DIONNE: You're saying there's more on the Medicare side than on the social side.

MR. _____: I agree with Henry that the timing of the Social Security-induced squeeze is more in the second half of Rudy's 30 years cycle than the first. And the major budgetary actions.

MR. HASKINS: Let me just make two brief points that I think, to talk about actual policies that might have an effect on Wednesday morning.

I agree with everything Bill said about faith-based and I think there will be, if there's a bill it will be a moderate bill so that will be my prediction. But I do think that is less important than the real issue which is can you make these programs grow? Can you have programs around the country? There's plenty of statutory authority. There's a fair amount of money. There could be a little bit more money, but a lot could go on in the country on faith-based, and above all to find out if it's going to work. We need good evaluations.

I think this is the next stage for people who really want to push the faith agenda is to get more programs in operation and carefully evaluate them to see if they work. So I think that's what, I hope that's what's going to happen. I know the Administration is pointed in that way. They've taken several actions in the last month. There are some more that are due, to try to expand the program. I'm not sure about evaluation.

Second, on the issue of cuts. I wish someone would tell me the title of the bill that's going to be introduced in the House and the Senate that proposes to cut TANF funding, to cut foodstamp funding, to cut Medicaid for children, to cut the earned income tax credit, let me say Nichols before anybody responds, and to avoid what in all likelihood is going to be an increase in child care sometime in the next six or eight months.

MR. AARON: The National Defense Full Employment Growth Act of 2002.

MR. HASKINS: And it will go down. In your own mind go through the Republicans in the Senate. There are a lot of Republicans, they could never get 60 votes for something like that. They could never get 50. Because there are too many Republicans that believe in a social agenda. When we get to [inaudible] keep going? Guess what? They don't. Something's got to give but it will not be big cuts in social policy. It just is not going to happen. Not in these entitlement programs that are the ones that really help working families. I think that part of the agenda will be the last thing that will be cut.

MR. DIONNE: Thank you.

Margie, that's the perfect segue.

MS. WALLER: Yes, it is.

Ron, let me ask this question about what's going to happen next year on welfare reauthorization. In '96 when the bill, as you point out, was widely supported by bipartisan vote passed, there was in fact an agreement that we were now going to require work and that it was a change in social policy that was significant. But the other part of the deal was, you work, we'll make sure you're not poor. And one of the ways that states have implemented that is to take the savings that they've gotten from [inaudible] payment of millions of welfare recipients have gone to work and used them for primarily child care but other low income work supports as well.

Are we going to avoid what Bill Galston has described as a likely very bad time for low wage workers by allowing states to continue spending dollars in that way? Or will the Administration continue to insist upon an increase in work requirements that would force states to pull dollars out of those child care and other work support programs?

Secondly, did I just hear you right? Were you saying the President's budget will not include a cut in the TANF block grant?

MR. HASKINS: Let me deal with the second one first. I don't think I'm at liberty to reveal what's in the President's budget and there are many parts of the budget I don't know and there will be things that are on the blocks for cuts. But there have been no discussions that I'm aware of, of cutting the TANF block grant.

In fact this gives me the perfect opportunity to point out that when the President introduced his bill last February, that there were virtually no cuts anywhere. In fact there were expansions, especially in foodstamps for non-citizens which was a major change in policy. And as I've already pointed out, the expansions of flexibility for the states if they're all taken together cost about a billion dollars.

On the top ten list of things that government does to help working families state TANF money is somewhere near the top.

(END SIDE A)

MR. AARON: I think particularly in the area of discretionary social spending, unlike defense and unlike Social Security and Medicare, you really have to look at the federal government and the states together in order to see what the picture is.

In the 1990s, as Belle pointed out, the restraints in this area until the very end of the decade, was severe. Growth rates in this area were very very low but they were robust at the state level. It is hard for me to foresee, because I think the state commitments in the late '90s dramatically overshot foreseeable long-run revenue streams, it's hard for me to see that the states are going to be able to pick up any of the slack that I expect at the federal level, which means to say that we have to look at the real political choices that are going to occur.

To pick just one, which will be my concluding particular note. Everything I know about the politics of Medicaid at the state level tells me that in a contest between the nursing homes and the poor people's lobbies, the nursing homes win every time. I don't like that any more than you do, Ron, but that's the way it always has worked and in my judgment that is the way it always will work. So I end where I began. That unless I'm missing something big, this is not going to be a pretty decade to be a low wage worker in the United States of America.

MR. DIONNE: I want to thank our panelists and our audience.

Henry's comment reminded me of another take on the same issue. Charlie McDowell, the legendary journalist, described politics in the '80s this way. He said we elect Democrats to Congress to get what we want and Republicans to the White House so we don't have to pay for it. [Laughter]

Now we have unified Republican government. We'll find out what we pay, who pays, and what we get, and we will be debating this again.

I want to note that anybody who wants to trip us up by what we said can find these words on the Brookings web site very quickly, within a day I think. I don't want to over-promise. And since we've had worms, mice and toads, I want to close by thanking all of our lions of social and economic policy for a great discussion. Thank you very much.

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