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RESTORING FISCAL SANITY: MEETING THE LONG-RUN CHALLENGE

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P R O C E E D I N G S

MS. RIVLIN: Good morning. I'm Alice Rivlin, and I am very pleased to welcome you to the Brookings Institution. I welcome you on behalf of the whole institution, and especially Strobe Talbott, our president, who regretted that he couldn't be here today.

We are releasing today this book, which is called Restoring Fiscal Sanity 2005: Meeting the Long-Run Challenge. You will recognize that this is not, in a sense, a "real" book; it is a photocopy. That is to get it out quicker. The words are, of course, all the same. But if you would like a fancier copy with a color cover and other accoutrements of a real press, that will be available early in May, the first week in May, and there are forms outside that you can fill out to get one and get a 20 percent discount—from some price that I'm sure what it is.

This book is called Restoring Fiscal Sanity: The Long-Run Challenge. Some of you will remember that we put out a book last year called Restoring Fiscal Sanity. We have not accomplished it yet. So we are trying again, but with actually a very different emphasis. The subtitle is significant. This book focuses on the big choices that Americans will have to make over the next several decades. Last year, we talked about alternative ways of balancing the budget over the coming decade, which, daunting as it is, is actually the easier problem. And now we shift attention to the longer-run picture. And this book is about the big choices that have to be made as the population ages and medical costs increase.

These choices, obviously, are the consequences of some very good news, two pieces of very good news. Americans are living longer and they are enjoying much more effective, but more expensive, medical care. How we pay for aging and medical care is a pervasive problem. It's not just a government problem. It affects families, it affects communities, it affects businesses and all levels of government. But we see it very starkly in the federal government, and the reason we do is that, even now, long before the baby boom generation is—not "long" before, but before the baby boom generation retires, we see that a large portion, around 42 percent, of the federal budget is devoted to Social Security, Medicare, and Medicaid, which are heavily programs for older people. Some of you may question why we put Medicaid in this category—that's for poor people, right? Well, it is, but it pays a very high portion of the nursing home care, well over half, and will be greatly affected by aging.

So as spending for these programs rises, we will have to decide as a nation what to do about it. Do we raise taxes to keep the promises to the elderly, do we slash other federal activities, or do we adjust the promises so they are not so expensive?

Moreover, we are still living with a near-term budget problem—this before the aging and medical care increase hits so heavily. We have a gap between spending and revenues in the federal budget of about 3.6 percent of the GDP. And as you can see from the lines on the right-hand side of the dotted line here, the projection lines, we do not expect this gap to narrow. Now, that expectation is based on what we think are reasonable assumptions—nobody knows what's going to happen in the future. It is based on the assumption that the tax cuts of 2001 and 2003 are continued, that the alternative minimum tax gets fixed so it doesn't engulf us all, and that defense spending for Iraq and Afghanistan and the war on terror continues in some reasonable way, the world doesn't suddenly get safer and that non-defense discretionary spending also grows with the population and with inflation.

Two things leap out of this chart. One is that the spending line, the blue line, is projected to be just about the average of the last several decades. It's averaged about 20 percent of our GDP. Revenues, by contrast, have recently plunged from their average of around 18 percent of GDP over the last several decades to about 16.3 percent last year. This takes us back to revenues as a percent of GDP that we haven't seen since the 1950s. And we don't expect, on our assumptions, that those revenues will increase very much, so the gap continues.

Now, why does this matter? It matters primarily because it means less saving—government deficit is the government dis-saving—and it means less saving just when we need more, to prepare for the higher costs for the future. It means we are passing the bill for current services of the government that we have all voted for to future taxpayers.

Now, could we get away with borrowing 3.6 percent of our GDP for a few years? Probably. It doesn't necessarily mean an immediate disaster if the rest of the world continues to be willing to lend to us. But that borrowing has long-run costs and it makes us vulnerable to a financial crisis if the rest of the world decides it's had enough of lending to the United States, particularly Asian central banks—which have an incentive to keep buying our securities, but that incentive could change. It means that we risk a crisis—the dollar plummeting, interest rates rising rapidly, and conceivably a recession both here and abroad. The risk of that may be small. Nobody really knows.

But why are we doing this? Why are we passing on the bill to future taxpayers when they will have to deal with the harder problems of aging and the rising cost of medical care? This is a moment when we ought to want to grow the economy as fast as possible because that's the only way to make that future tax burden lighter for those future generations.

What can we do about the near-term problem? Well, only two things: We can cut spending and we can raise revenues—or some of each. In last year's book we illustrated how one might go about that, what the consequences would be if one tried to cut the deficit entirely on the spending side, by cutting spending—which we called the small government plan; or, if one wanted to add spending, then one would end up with a much higher tax increase, clearly; and we offered a program in-between.

We also believe very strongly—I think all of us who participated in this project—that we need to restore discipline to the budget process. Something like the Budget Enforcement Act of 1990 has to come back. At that point, we had a bipartisan consensus that the budget deficit was a problem—not a bipartisan consensus on what to do about it, but a Congress and a president willing to say this is a big problem and we are going to impose rules on ourselves that will force us to bring the deficit down.

But now for the longer-run problem. This chart only looks at the three programs that we said earlier were over 40 percent of the federal budget, Social Security, Medicare, and Medicaid. If we project those forward, assuming that the promises are kept, and assuming, most importantly, that medical care costs continue to rise in the same relation to the growth of the economy that they have over the last 40 years—namely, that they grow about 2.5 percent faster than the economy is growing. That's largely because medical care has gotten better, but it has also gotten more expensive. If those assumptions hold, then what we see is the spending of the federal government rising extremely rapidly and, by some time in the 2030s, eating up what is currently the entire federal revenue of about 18 percent of GDP.

Two things leap from this chart. One is that Social Security, which we'll talk more about later in the program, is an important part of the problem but not a very big part of the problem. If we pay all of the benefits now expected under Social Security, we would increase spending from about 4 percent of GDP to about 6 percent over this very long period.

The big problem is medical care, the two medical care programs, and those are much harder to fix. They can't be fixed by the government alone because the problem is that medical care costs are rising for all of us. They're not temporary. You see Social Security benefits leveling out after awhile; the medical ones keep on going because there's every reason to think that medical care will get better and better. So even if we succeed—and my co-authors will talk about how one might—in lowering that increase in the cost of medical care, we have a problem.

Now, how did we pay for this increasing cost in the past? If you look at this slide, you will see clearly one of the things that happened over the last several decades is that the cost of defense as a percent of GDP came down, and partly that enabled us to pay the higher costs for Social Security and Medicare. But that's not necessarily repeatable. We can't get another 4 percent of GDP out of the defense budget.

The other thing that leaps from this chart, which assumes that revenues return to their historic level—in this case, about 18.4 percent of GDP—is that that won't cover the spending so we have to borrow more and more, and the interest on that debt will explode eventually, even at lower increases of Medicare.

So this is the dilemma. We have to do something drastic over the next several decades: What will it be? Will we keep the promises to the elderly and raise taxes? Will we cut everything else? Will we restructure those promises? That's the thing that has to be thought about.

For all the answers to that, I turn you over to Belle Sawhill.

MS. SAWHILL: Good morning. As Alice has noted, we face some very big choices going out into the long run. Let me just try to summarize those choices.

If we want to keep revenues at or below current levels, we're going to have to accept draconian cuts in spending. And when I say draconian, I really mean draconian. On the other hand, if we want to maintain current commitments to the elderly and continue to fund the rest of government more or less at current levels and maybe have a little extra for some new initiatives, then we're going to have to raise taxes to what would be unprecedented levels for the United States.

So I want to put just a little flesh on those two bare-bones scenarios that we lay out in the book. Actually, we have four scenarios that we describe and estimate the costs of in the book. I'm just going to mention these two extremes here. The other two that I won't talk about fall somewhere in the middle. All of them address the question of what we want our government to look like and how much we want to pay for it 25 years from now, or in the year 2030. So let's start with this smaller-government scenario.

We asked ourselves the following question: What would you have to do to keep taxes at current levels as a proportion of the economy? The first thing you would have to do is to ask seniors to pay a lot more for their own health care and their own retirement. There are lots of different ways to do this, such as indexing Social Security benefits to prices instead of wages, such as raising retirement ages, such as capping health care spending so that it grows no faster than the economy, such as asking seniors to pay higher Medicare premiums. We deal with all of those options and others in the book, and you'll hear more about them in the last panel today.

In addition to asking seniors to pay more, you would have to eliminate a lot of other things that the federal government currently does—most commercial and farm subsidies, housing, education, job training, environment and crime programs. And you'd have to keep defense spending below about $400 billion a year. In today's dollars, that's about 20 percent lower than defense spending is right now. And the reason you have to do all these draconian things is because the aging of the population drives up costs and because of health care cost inflation, all the things that Alice just talked about. So if you want to keep taxes more or less at current levels, and especially if you want to reduce them, you have to drastically cut back all of these current commitments.

Now, if you do all of these things, you can actually reduce taxes just slightly in a way that most conservatives would like and have been arguing for in recent years. However, seniors would be very hard hit. For example, right now they pay for about 40 percent of their own health care. Under this scenario, they would have to pay about 70 percent of their health care expenses. And they would have a much smaller Social Security check out of which to pay those higher expenses.

So let me contrast this now to the larger-government scenario. In this scenario we maintain existing commitments to the elderly and we not only continue to fund the rest of the government, including a strong defense, but we add a little money for some new initiatives such as providing universal pre-K, providing more health care to the uninsured or the poorly uninsured in the non-elderly population, and adding enough foreign aid to meet the millennium development goal aimed at fighting poverty in the less-developed part of the world. There's a whole menu of such larger government initiatives in the book, all described and costed out for some future Democratic candidate to grab off the shelf.

But the consequences are that total spending rises from 20 percent of GDP to 28 percent. I should clarify that that's not so much because of the new initiatives; it's really because of the health care cost inflation that Alice talked about earlier. In fact, these new initiatives are cheap, really cheap, in comparison to what we need to do to maintain an aging population. Under this scenario people's taxes would have to go up a lot. The average family would pay an extra $11,000 in taxes a year—$11,000 more than they pay now; more like what most Europeans currently pay.

This next chart shows you another way of looking at all of this and what it means for the average household's income. Between now and 2030, incomes will rise a lot just because of economic growth. By 2030, the average household will have almost $100,000 in income in today's dollars. But in the smaller-government scenario, after-tax income grows almost twice as fast as in the larger-government scenario. Put differently, the issue here is how any growth dividend is going to be divided between making people better off and paying for a bigger government.

Now, you're probably saying to yourself right now both of the scenarios are pretty unrealistic, and you'd be right. We're not likely to ration health care, index Social Security benefits to prices, and cut the rest of government by $400 billion a year. So our point is that that's what keep taxes at current levels implies—not that we're necessarily going to do it. By the same token, we're not likely to raise taxes to the levels paid by most Europeans. That's just not in the U.S. tradition. So what are we going to do? We don't know, of course, but we think people should start focusing on these big choices because they have huge implications for the kind of country we will be 25 years from now.

In the last chapter of our book we look at how the political system in the United States has dealt with these kinds of tough fiscal issues in the past. We look, for example, at the '83 Social Security reforms, the 1986 tax reform bill, and the three big budget deals that were agreed to in the 1990s. And out of that history, we extract six lessons. You can read them off the slide. Most of them are self-evident. I might mention, however, that as an example of unorthodox methods of legislating is the use of outside commissions to provide political cover or deniability to the White House and Congress dealing with very contentious issues. And you will shortly be hearing from two people, John Breaux and Bill Frenzel, both of whom have been very involved in such efforts.

With respect to budget rules Alice mentioned, we think that such budget rules as PAYGO and caps on discretionary spending that we had in the past helped to provide fiscal responsibility through the 1990s, but in the current environment, even they have become contentious. Most Republicans in Congress want PAYGO to apply only to spending and not to taxes, while a minority of Republicans and most Democrats believe that such rules need to be applied in a more across-the-board manner.

We also conducted interviews with 20 Washington insiders. Ron Haskins will say more about these interviews later. But to summarize, overall there was enormous pessimism that Congress was going to have great difficulty moving the country toward greater fiscal sanity in the next few years; in other words, that we weren't going to have very much progress. Republicans in Congress are not willing to raise taxes. I think that's clear right now. Less clear has been what they would do on the spending front, but I think what we learned from our interviews and what we're seeing to some extent as this story unfolds this year is they haven't been willing to make the kind of spending cuts that we suggest would be needed in this book, either, if you want to keep taxes at current levels.

So what are the big conclusions here? Current deficits, do we believe, threaten economic well-being? Unfortunately, the earlier consensus that existed in the country and in the White House and in the Congress about the fact that deficits are very bad for the economy seems to have evaporated, to some extent, which is making it difficult for us to move forward. Economic growth could help deficits to decline in the short run, but there is no way that any plausible rate of economic growth could prevent them from ballooning in the longer run. As Alice mentioned, Social Security is certainly a problem, but Medicare is a much, much bigger problem.

These fiscal imbalances are huge as you look out 25 years. They do present an opportunity for us to rethink what kind of government we want to have and how much we're willing to pay for it. But whatever we do and whatever we decide, taxes are going to have to be raised and spending cut just to deal with current deficits, and the sooner that's done, the better. Right now we're not seeing a great deal of leadership on these issues from the White House or from the Congress. I think that if you look just at the two budget resolutions that were passed in the House and the Senate in the last few weeks, both of them increased rather than reduced the deficit over the next five years.

So I'm going to leave it at that. We probably should—I don't know if we're ready to move on to the next panel or I should take a few questions and comments first.

Is Senator Breaux here? Not yet. Okay, why don't we have a little—turn up the lights and have a little discussion, questions for either Alice or myself. Maybe Alice will come back up again.

QUESTION: My name is James Witt [ph] and I'm with [inaudible].

The chart that shows that income actually rose up under the larger-government plan is rather intriguing. Would you talk more about that?

MS. SAWHILL: Sure. You know, the Congressional Budget Office projects that economic growth is going to be 2.4 percent a year, real GDP growth, between now and 2030. So, you know, the miracle of compound interest is that everybody's income is going to go up as a result. And so even if this larger-government plan is expensive, it doesn't absorb the entire growth dividend. The rest of it enables people to have more private goods, more consumption, if you will, and it's really matter of what the division is between public and private goods—you know, how you want to use that growth dividend. Does that make sense?

QUESTION: Miles Benson with Newhouse Newspapers.

I was intrigued by—I think you said the average family would have to pay an increased tax bill of $11,000 if we went the larger-government route. Putting that number next to the increase in income that is projected over those years as well makes them more able to bear a larger tax burden, obviously. That number was adjusted for inflation, wasn't it?

MS. SAWHILL: Those are real dollars, correct.

QUESTION: Can you tell us what kind of proportional impact that $11,000 increase would have on the average taxpayers at that increased level of income?

MS. SAWHILL: You know, I think that the chart shows that. If you need a table that has the actual numbers in it, we can get that for you. You know, the average household's income right now is about $67,000 a year, and it goes to $96,000 by 2030. And we then simply took the tax bite out of those pre-tax numbers to look at the after-tax income under these two scenarios.

QUESTION: So instead of having $98,000 of income—

MS. SAWHILL: Fifty-eight.

QUESTION: —they'd have $11,000 less, which is still substantially—

MS. SAWHILL: Well, no, the $11,000 is the comparison between the taxes you would pay in 2030 under the larger- versus the smaller-government plan. And you may be asking me what are—that's the difference between the two plans.

MS. RIVLIN: No, I think he's got it right. I think he's got it right.

MS. SAWHILL: Yeah. Okay. But it's not the change from now.

Jane Sturley [ph] is saying those taxes do come back to people, and I think this is an important point. I met with a group of business in New York recently, and they said, well, clearly the way to solve this problem is simply to increase productivity in the federal government. But I think what they're forgetting is that most of this money flows in the tax doors and then flows out the spending door, and it goes to people for health care and for Social Security benefits and for farm subsidies, veterans benefits, and for a whole lot of other purposes. Now, the government does, of course, do some things in-house, but a lot of this is a flow-through problem and it's who's paying the bills and who's getting the benefits.

QUESTION: [Off microphone, inaudible.]

—are snapshots of 2030. Going forward from 2030 to, say, 2050, are there going to be more cuts or more taxes implied in the scenario?

MS. RIVLIN: Well, I think that entirely depends on what happens about the cost of health care. I see this as an endless problem that we will be struggling with forever because I think medical care will get steadily better. Some of the innovations will be cost-saving; most of them will not be. Henry Aaron and Jack Meyer are going to talk more about health care later. But I think the answer to your question is these problems don't end in 2030 or 2050. To the extent that we're dealing with Social Security, there is a bulge in the near term as the baby boom generation retires. And people will continue to live longer, but we don't know how much longer, but that will tend to level off. But health care doesn't level off. Health care keeps going.

QUESTION: David Dickson, the Washington Times.

Some data on a sheet for a subsequent presentation shows that total health care costs in the United States are about 5.6 percent of GDP right now, and 4.2 percent of that is Medicare/Medicaid. So that would leave about 11 or 12 percent private. In your presentation, you said that if we had all these big tax increases, there would still be lower taxes than 17 industrial countries. But they all pay for 100 percent of the health care. Have you got any real comparable data that would indicate what our tax burden would be if we still had to pay 12 percent of our GDP on health care relative to the other industrial countries?

MS. SAWHILL: We might want to defer that for Henry and Jack to talk about later.

MS. RIVLIN: I think so, although the total U.S. health care expenditures now are around 15 percent of GDP. It's been rising rapidly.

MS. SAWHILL: I mean, you're absolutely right that we spend a lot more of our GDP on health care than other advanced nations. The question then becomes could we get down to their levels without—Henry, do you want to come in now?

MS. RIVLIN: Henry, come on. Henry Aaron.

MR. AARON: The important question is whether we're getting value for money. If, for the additional roughly 5 percent of GDP that we spend on health care relative to the more generous countries in the OECD, we were getting significantly more health care services, enough more health care services to justify the added spending, there would be no reason to consider that a burden. It would be a consumption decision by the nation to allocate a larger proportion of our wealth to health care.

The real question here, I think, for health care policy, not just for government policy but for the nation as a whole, is whether we indeed are getting enough more health care services for the additional spending that we undertake. There are reasons to think that we may be buying a whole lot of relatively low-benefit services and that welfare could actually be enhanced if we spent a bit less on health care and a bit more on other services. But that's really a larger topic than the one addressed in this volume.

MS. SAWHILL: I'm going to suggest—I see that Senator Breaux is here, and I'm going to suggest that we change places here. We're not going to take a formal break, but it might take us just a minute here to rearrange the deck chairs.

[Laughter.]

Implications and Prospects

MR. GALE: I think "rearranging the deck chairs" is apt in more ways than one.

In the first session, Belle and Alice laid out the fiscal situation and the nature of the potential solution. The problem is just the simple one that Americans are willing to have their government spend more than they're willing to pay in taxes. The solution is also a simple one. Either spending has to come down or taxes have to go up, or both. Belle and Alice, I think, rightly emphasized that this is an opportunity, not a disaster. I would change that slightly to say this is not just a disaster, it's also an opportunity. The nation could use the situation as a chance to restructure its existing spending and tax rules as well as realigning the levels, which is the first order of business here.

In this session, we're going to build on that base. We're going to talk about some of the implications of the fiscal and economic situation we face and the prospects for doing something about it. I'd like to emphasize that one possibility is that political leaders, perhaps encouraged by the voters, would actually do something constructive about this and actually solve the long-run fiscal balance. But that's only one option. A second option is that nothing happens, at least for a long time. And a third option is that the fiscal imbalance is used as sort of a poster child for any politician that wants to advocate whatever he or she wants, in many cases actually making the situation worse. And this is not a hypothetical situation; this, to some extent, is what happened the last four years.

So to discuss these issues we have—I was going to say two of the most preeminent people, but right now it looks like we only have one. Our first speaker is Senator John Breaux. He was elected to the House of Representatives as a Democrat from Louisiana at the ripe old age of 28. He served in the House for 14 years and then in the Senate for another 18 before retiring in 2005. He is currently a senior counsel to Patton Boggs.

More than all that, although maybe in addition to all that, Senator Breaux is known for his leadership and his interest and ability in forging bipartisan solutions and finding common ground among warring parties. He was a founder of the Centrist Coalition in the Senate, he served as chairman in the Democratic Leadership Council, and for a speaker who's going to tell you about long-term budget issues, he has the unique trifecta. He was the co-chair of the National Bipartisan Commission on the Future of Medicare in 1998. He held the same position in the National Commission on Retirement Policy in 1998. He is currently the co-chair of the President's Advisory Panel on Tax Reform. So he is the right man at the right time.

Our second speaker was going to be Harvey the invisible 6-foot rabbit, but it turns out it's Bill Frenzel instead. Bill served in the House of Representatives for 20 years as a Republican from Minnesota. He is currently a guest scholar here and a valued and treasured member of our staff. He is also known for both is leadership and his interest in finding common ground. In the House he was the ranking minority member on the Budget Committee and, as his vitae notes, he was the principal Republican economic spokesperson until he left the House. That position seems to remain unfilled since he left. He has also served as a special advisor to President Clinton for NAFTA and as a member of the Social Security Commission that President Bush created a couple of years ago. And he is also a member of the president's tax reform panel. Among his many other honors and duties, he is co-chair of the Committee for a Responsible Federal Budget.

So before I turn it over to the panel members, I want to congratulate Belle and Alice on choosing two people who are so intricately connected to the long-term fiscal spending and tax issues. And I want to note what an honor it is to be able to moderate this panel.

We ask each of the panel members to speak for 15 minutes, and then we'll take questions from the audience. Thank you.

SENATOR BREAUX: Well, good morning, everyone. Delighted to be here and particularly to share the podium once again with our traveling partner, Bill Frenzel, who serves, as Bill said, as a member of our tax reform panel and does a great job in that capacity, bringing a sense of reason and balance to our discussions.

To Alice and Isabel, thank you so much for letting me participate in the workings today. And congratulate Brookings for what is really, I think, a tremendous piece of work. What the scholars have written and presented in this I think, really goes a very long way into helping to give Congress what they need, which is guidelines and real thoughtful, nonpolitical recommendations, which are sometimes so rare in our city. So it's a real important document. Hopefully, those in the policy levels of government will take a look at it, because it is really reflective of some of the solutions that we should be considering.

Let me just say a little bit about the climate and the atmosphere that all of this is going to be looked at with regard to the Congress. I think that the thought of the type of panel we have on the tax panel, it really is a real nonpartisan, nonpolitical panel—as opposed to the National Medicare Commission that I had the privilege of chairing, which was a commission that was appointed by our elected leaders—the president, the speaker of the House, the majority leader in the Senate, Democrat, Republicans. And when you have those types of panels that are constructed under a political scenario, each side tends to appoint the strongest advocate for their position they possibly could have to serve on the panel. And what that does in many cases is produce gridlock. And, you know, many times those types of panels, I can tell you the result before they have the first hearing because people who already have hard opinions don't change them very easily.

I remember telling Bill Clinton, President Clinton after the panel completed our work, I said, Look, the next time you appointment a commission, make sure you appointment really smart, intelligent people who know nothing at all about the subject matter so that they can come to the commission or the panel with an open mind and listen to the documentations, the testimony and arguments, and then reach intelligent conclusions about a recommendation.

I think our panel on the tax panel has that opportunity, because the people certainly, other than myself and—Connie would probably say he's in that position, too—the rest of them are truly tax experts who, really, have doctoral degrees in tax policy, who have run the Internal Revenue Service, who teach tax law, and really don't have a political agenda in their bones. And I think that's very good. That's the type of panel you need to produce positive results when you're dealing with something as difficult as tax policy.

The Congress today is a very difficult place to find consensus and bipartisanship. If you look at the House, it's almost become a body that looks to the Ethics Committee as a committee of original jurisdiction—if you don't like someone, you know, let's file charges. And that's happened back and forth on both sides, and you see how that's playing out now. That makes it very difficult to reach compromise. And you add to that in the House the situation where almost all the members are in safe congressional districts. Maybe 20, maybe 30 out of 435 members of the House really have anything approaching competition in their districts. The districts are generally now constructed to be all-Democratic districts, all-Republican districts. And if you're in an all-Republican or all-Democratic district, you don't have to deal with those in the minority in your congressional district. If it's an all-Democratic district, you don't have to worry about Republican ideas because they don't count in the sense of getting reelected. And the opposite is true for Republican-controlled districts. You really don't have to deal with Democrats in that district in order to get reelected. That makes it very difficult to reach a legitimate compromise on the floor of the House and the big issues facing today.

The Senate, unfortunately, I think has moved from a more collegial type of atmosphere in the last Congress to something that's more polarized even there. More and more, members of the Senate are now former members of the House. And I was a former member of the House, and most of us all were. But many of them are bringing the ideas about that polarized war zone that's called the House of Representatives over to the Senate now and it's making it even more difficult. You add the attempt to change the rules of the Senate, the so-called nuclear option on the judges; it's going to make it even more difficult. You could easily end up with a situation where everybody loses. And then they fight over whose fault it is that the Senate has come to a screeching halt.

So that's the atmosphere that we are operating in today, and it's a huge challenge. It's more difficult now than it was last year, more difficult than it was five years ago. And that's unfortunate, and maybe it will take another breakdown in order to bring back that sense of comity that we had. When I was in the House and Tip O'Neill and Bob Michael were the ranking leader and the speaker of the House, I mean, they didn't agree on a lot of any policy matters, but they worked together, they drank together, they played cards together, played golf together, and they had a working relationship that I think was good and good for this country. And I think that when you lose that, you really lose the ability to reach agreements on difficult subjects.

Let me just talk about a number of things that this report deals with and then move on to some other areas and questions, and listen to our colleague Bill Frenzel.

Social Security. I mean, I do not think that this Congress is going to do anything on Social Security. Is it a problem? Yes. Is it a crisis? No. Should it be addressed? Yes. But unless you have a consensus, it's not going to happen. The president is doing what he should do to try and convince the American people that these changes should be made now, but he has not been able to do so. Those who are opposed to changes are much more opposed to the change than those who are for it are for it. When you have the AARP doing their bit rounding up opposition from seniors, going to all the public meetings around the country, there's a very difficult bridge to cross. And they have not convinced members of Congress, when you don't have the American public behind you, that they should be investing the political capital into solving a problem that at best does not occur till the year 2018, maybe 2017. And with the trust fund borrowing the money, you could arguably say that everybody will get their full benefits to the year 2041.

So members of Congress are saying wait a minute, there's no consensus in the public, the problem does not occur at the earliest till 2017, why am I going to stick my neck out when there's no consensus and make changes which many people do not agree with. And I think the White House should be looking for an exit strategy. They've made a great effort; they've tried. But it hasn't happened and I don't think it's going to happen.

A much more serious problem is Medicare and health care. I mean, right now today, as we sit here at Brookings, there are about 40 million people in this country at one point in time in the year do not have any health care at all. That's not in the year 2017, that's right now today. We're projecting that Social Security will have a problem in 2017, but until then everybody gets full benefits every month, never miss a check, and yet Medicare and health care in general, we still have a significant number of Americans who do not have the benefits of health care. It would be much more important, I think, for the Congress to invest the capital in health care in this country than in Social Security, the resolution of that particular problem.

There are things that need to be done. I would have and recommend an individual mandate for people to buy health insurance. It's not an employer mandate, but it's an individual mandate that would say everybody, just as they have a requirement to have liability insurance if they drive an automobile, would have to have health insurance if they are an American citizen; and that American citizens would be entitled to health care not because we put them in a box somewhere, like we put them in the Medicare box or the Medicaid box or the Veterans Administration VA box or the Uninsured box or their employer-sponsored health box, but they should have health insurance because they're an American citizen. And those on a low income are not going to be able to have enough money to pay for it, but the government's going to have to help them pay for it. And the government can help constrict purchasing authorities by combining states that would create purchasing authorities so that no one would be subject to adverse risk selection. And low-income people would have an ability to in fact be helped with the premiums for a basic health insurance plan.

I think in the tax code we can do some things that I would like to see done. We have not made any decisions on this at all. But it will be part of the discussion. I intend to bring it up, and others, I think, have sympathy for it as well, that we would make adjustments in the tax code. What about considering, like Jane Sturley's talked about here and in other forms, a recommendation of an idea that would say should there not be some limit on the not counting of the premium contribution of an employer to high-income individuals, and say that at some point you should have to pay tax on that? The answer, I think, is yes, and use those funds in order to help pay for the premium assistance to lower-income Americans to get them into the system. A lot of the people without insurance are younger, healthier people who work every day, but work for companies that don't provide health insurance. The more people you get in the pool, the more you can manage their health care, the more you can do preventative health care. You can't do preventative health care for people who don't have health insurance. You don't know where they are, when they're going to get sick, or what kind of a lifestyle they're following. But if they're in the insurance pool, you can do that. I think that is something that should be considered and is very important.

One of the things we did in the Medicare legislation last year, which I thought was very important—I wanted to mandate it, but we couldn't do it—was that now when someone comes into the Medicare program for the first time, they have the government be willing to pay, and is going to pay, for a baseline physical for all of those individuals. I mean, what insurance program wants to take people who you don't know what their health condition is? So if you can bring people into Medicare and have a baseline physical to work from, you can look at them and determine, in a preventative manner. If they are a candidate for cardiovascular problems, you put them on Lipitor or whatever and help manage their diets. If you think they're a candidate for diabetes, you help manage that now so you can delay the advent of that disease or perhaps prevent it from occurring at all. So having people in an insurance pool and having the ability to know what their health conditions are, I think, is very, very important.

There are just so many things we can do, and I won't waste your time listening to all my crazy thoughts. But long-term care is absolutely essential. We spend so much money on 24/7 health care for seniors in nursing homes when many of them in there don't need to be there. They need assistance, they need help, but they don't need it 24 hours seven days a week. And that means they need some type of assisted-living home health care. We ought to use the tax code to help encourage the purchase of long-term health care insurance so that when moms and dads and grandpas and grandmothers need that extra help, they would have some type of ability to have an insurance that would be available to give them that type of health care that they need. I think that's very, very important, and hopefully we can do something along those lines in the tax panel that we're working on.

So this is a huge challenge. I think it's much more important to deal with health care and costs in terms of the greater amount of money we're spending every year on health care in this country. I think we can spend it much more wisely. When I chaired the Aging Committee, I said many times, sort of jokingly but also with a certain degree of truth, the good news and the bad news. The good news is that people are living a lot longer. The bad news? People are living a lot longer. In a sense, the cost that we have in taking care of a larger and larger segment of our population which are moving into senior status, and not only are there more in that category, where there are because of the baby boom generation, but that group which is larger than ever before is living a lot longer than ever before.

So in considering how to do these things and looking at things, we have to look at tying the eligibility age for some of these entitlement programs to the average life expectancy, trying to figure out a relationship. That's what they did in 1935. Congress was pretty smart in picking 65 as the retirement age. The average life expectancy then was 64. Congress said, hey, no problem here. We can take care of this. But now as it approaches 80 and you still have the retirement age basically about the same, we have to address these things. You cannot take the position—and that's why this book is so important—that many members would come before the Finance Committee, I'm sure the Ways and Means Committee, and they'd say, Senator, fix Social Security. Fix it, but don't reduce my benefits. Fix it, but don't increase my taxes. Fix it, but don't increase the eligibility age. But darn it, fix it. So when you take all the options off the table, then you have no choices and you just have a continuing logjam.

This book presents options, and I think that's one of the very good things that it does. I'm looking forward to helping members understand what it's all about.

Thank you all very much.

[Applause.]

MR. FRENZEL: I am not Harvey the 6-foot rabbit—I think. I'm delighted to be on this panel and to be with my co-chairman of the Advisory Panel on Tax Reform, and other luminaries, Alice and Belle and all of their authors, to talk about the Restoring Fiscal Sanity.

John and I had the assignment of talking about the implications and the prospects. Alice and Belle have laid out these alternative scenarios with the implication that there is an infinite number of places in-between that one could land, but it would be cheerily hoped that occasionally the policy makers might want to bring the two lines together and that we might think of trying to get our budget into balance at some point in the game. That, I take it, is the message of Restoring Fiscal Sanity—at least that's the way I read it, and it appeals to me.

So my intention was to find some glimmer of hope or light at the end of the tunnel. And I hoped that John would find some, too, and maybe help lead me to it. However, I can't find that light and I can't find any immediate grounds for optimism. So I come to you wearing a black arm band on the subject of fiscal policy. For me, the bad news is that we can probably, all of us, agree with Belle and Alice and their authors that we are on an unsustainable path. They've shown that emphatically and, to me, correctly.

The worst news is that I don't see any short- or intermediate-term prospect for changes that are likely to divert us from that path. Certainly in the current election cycle, I don't see it. The political system's various policy making terms, that is, the elected political party leaders and their followers, I think understand these problems intellectually. I hope the book will help them to a better grasp. But I don't think they feel it in their political guts yet. The problem of the restoration of fiscal sanity, or what I call fiscal sobriety, is not at the top of their wish list at the moment. That is to say they are feeling more pressure from their core constituencies at both ends of the spectrum than they are from the general public.

After the deficits which our country incurred from 1968 to 1994, about a quarter of a century, the public apparently noticed and decided to make some changes in the Congress. Now, if that frightening precedent prevails, we can wait till about 2025 before the public will be discouraged and be willing to send in some fresh troops to rescue us. That's not a great precedent, and I guess in the end we will probably all look to Herb Stein for salvation.

The challenges are intimidating. I'm not going to call the roll of all of them, but some of the worst, of course, the demographics and the rise of entitlements, Belle's scary slide here that shows the cost of the three major entitlements running through at least our willingness to raise taxes to support them, Congress's absolute unflinching propensity to spend, and Congress's new urges to cut and reluctance to raise taxes. Alice raised the specter of financial crisis, market collapse. That's usually not what happens, but if relief doesn't come at some point, perhaps it will. And finally, there's the—I think morality lectures are always best served up on Sunday, but from Monday to Saturday the thought of dumping all these obligations on our progeny at least raises some of those specters in my mind.

And that unsustainable path takes us to the point that Belle pointed out, where we have one soldier, one sailor, one Marine, and one Air Force man in our army, and no other discretionary expenses. Maybe a handful of air controllers. Not a very pleasant prospect.

The other point the book makes which I think is terribly important is that a number of authors repeat the statement: we need to act now. That is, the sooner we act the less abrupt and the less disruptive the corrections are going to be. Where the solutions are clear, we should try to avoid future train wrecks. I think Social Security is a great example in this case. I don't mean that the solutions are going to be universally embraced; I only mean that there's a certain number of reductions of benefits and increases of taxes you can make, and you have to sit down and figure out which ones you're going to deal with. Of course, we have a bad precedent there, too. In 1983, Congress diddled until we were about 90 days away from not being able to send Social Security checks. That's the kind of pressure—Congress is usually a much better crisis manager than it is a routine manager, and that's part of our system, I guess.

Next question is, are the budget rules going to save Congress? Well, they aren't going to save us if they aren't applied. And somebody, either Belle or Alice, pointed out that Republicans find it inconvenient to accept PAYGO because that stifles their tax-cutting aspirations. But it also makes it very difficult to apply any discipline in dealing with fiscal matters in our legislative process. Obviously, we need those. On the other hand, long-term, and again looking at history, rules aren't going to save you. They can help you. But they aren't going to change the way future Congresses are going to react to certain problems.

You're going to hear a lot more about the factors that affect, but I do want to mention bipartisanship, because in our system there is a dual responsibility. Our system requires the tacit approval of the major players, in this case D's and R's, to make substantial policy changes. Political scientists have what they call the theory of the concurrent majority, which in our system says the majority eventually gets most of what it wants, but the minority is not overrun and it has the opportunity to make some stoppages along the way. And this is true with or without the filibuster, which we don't know whether they're going to screw up this year or not. Net is neither party can hide, both are accountable. The R's have to lead because they're the majority, but the D's have to be more than obstructionist. And both have much to show us yet.

Finally, I want to talk about public responsibility because in a democracy that's where it all resides. It's very hard to get either party's attention when 95 to 98 percent of incumbents seeking reelection are handily reelected. And as a matter of fact, this tends to drive the parties to the polls. I think John was mentioning the districting which makes districts safely Republican or safely Democrat, and therefore the only challenge comes in a primary. And so, again, you appeal to the primary voters, which are the most extreme in both parties, again forcing the parties out to their extremes.

Politicians have to give some leadership, but they aren't going to unless the public demands more of them. I think the Brookings tome has shown them, and I hope that they will profit from it. But the people have to get off their duffs, too, and demand more of their policy makers. If they do so, it will make that Herb Stein prophesy real, and that is that which cannot be continued will someday stop.

Thank you.

[Applause.]

MR. GALE: All right, thanks. I don't think it's a coincidence that we just heard two such reasonable sets of comments from former members of Congress.

[Laughter.]

MR. GALE: I want to exercise the chair's prerogative here to ask the first question.

Normally when there's a disagreement, you have sort of two sides agreeing on the problem and suggesting two different solutions. So you could imagine a world in which both parties say, yes, there's a fiscal gap, yes, we have to solve it. One group says we need to solve it with tax increases, the other group says we need to solve it with spending cuts. That would be a normal reasonable debate. You would expect some sort of compromise in the middle. And if you really had high hopes, you would expect some restructuring of spending and tax policies at the same time as you go the alignment of the levels.

That's not what we see right now. We see one party, which shall remain nameless, which says that we have crises all over the place in the fiscal situation. At the same time, this party is cutting taxes like mad, it's signing the No New Taxes pledge, which removes the opportunity to raise taxes, it's raising spending like mad, creating the biggest entitlement in the last 40 years in Medicare, and is not cutting Medicaid spending. It's unable to cut Medicaid spending. That's one side. The other side is doing absolutely nothing but saying there's not a crisis, we have no forward thrust on spending policy, we have no forward thrust on tax policy. This isn't even the debate.

So how do we get from here to even having a reasonable debate that acknowledges there's a problem and that there might be a solution in the middle? I can't think of two better people to answer that question than— Senator Breaux, why don't you take the first crack?

SENATOR BREAUX: Well, we could talk about this for the rest of this week and the rest of this month and never finish the discussion. What you outlined in the beginning, Bill outlined, was political science 101. That's how it's supposed to work. But obviously it's not how it works in reality. I think part of the problem is the fact that there's not enough dialogue between the two parties. The two parties have become like armed camps. The political advisors in both parties immediately tell both parties that if it's the other side's idea, let's figure out how we can be against it, instead of trying to figure out how we can work to try and modify it enough to match our goals and our ideas.

I can't tell you how many times I've had people, you know, in party discussions say, look, the other side's come up with this idea; how do we argue against it, what's our best talking points against it? Never the idea of how do we try and reconcile it to what our beliefs are to bring them into the fold. A lot less cross-pollination, if you will, between the members now. The House is in session Tuesday, Wednesday, and Thursdays; they go back to their districts, they're in safe districts, and there's less interaction between the parties.

In the Senate, Russell Long used to tell me how Republicans and Democrats got together regularly for lunches and talked about problems and resolved things and talked about them over drinks in the evening and came up with real solutions. Democrats meet every Tuesday by ourselves, talk to ourselves, listen to ourselves. Right across the aisle, Republicans are doing the same thing, only talking to Republicans and listening to their ideas. And if you only talk to yourself, you're only going to hear echoes of yourself and you're never going to hear the other side's ideas and concepts about how to make government work.

So that is sort of the physical impairments to bringing people together. We end up trying to figure out how we're going to blame the other side for failure. I've said this so many times. Instead of trying to bring both sides together, accomplish something, then we can fight over who did it. I mean, I'll go tell them in Louisiana I did it. And if someone in California wants to say, no, I did it, that's fine. That's a legitimate argument. We're talking about success and who accomplished it, as opposed to arguing about failure and whose fault it was.

Let me give, just in conclusion, an example: the Medicare legislation last year. There were Republicans in the House who really argued that we're going to be against it because we can blame it on the Senate Democrats for killing it. There were some Democrats in the Senate who said we can't pass this because it would all President Bush to have a signing ceremony in the White House and take credit for it. So you had two parties coming up with the same position, let's kill it, for totally opposite reasons. I mean, we're going to kill it because we don't want Bush to be able to sign it; we're going to kill it so if we do that we can blame the Democrats in the Senate for killing it. I mean, what about the 40 million people who should be the topic of the discussion about how to improve the system? But it became so involved in the political arguments that the merits of who we're trying to help really became secondary to the political discussions.

MR. GALE: You're saying when President Bush said he would be a uniter, not a divider—it's a very interesting unification.

SENATOR BREAUX: But it didn't last very long. I mean, I think that—I mean, one of his themes eight years ago, seven years ago when he ran, it was a terrific theme: compassionate conservative. I mean, you know, I'm going to be conservative, appeal to the base; I'm going to be compassionate, appeal to the more liberals. And it was a great concept, but it didn't carry out for a very long period of time.

MR. FRENZEL: I think John's laid out the problem correctly. We're in an environment now where the nation is pretty much split down the middle between blues and reds, D's and R's. And any flinching on the part of either side leads the elected politicians to believe that it will either preserve a majority or create a new majority and topple one. That's the last thing that either side wants to happen. Neither side seems to be able to show any favors to the other for fear that they'll be run out of their own group.

In this poisonous environment, which already has been described; that is, if you propose something, I don't make a counter-proposal, I merely beat up on yours. And this is true on both sides of the aisle. So that means nobody wants to make the first proposal. The president has been out promoting a Social Security program for 90 days without having a Social Security program. The Congress has been just assiduously resisting talking about it. I think, as John suggested earlier, they're probably going to resist voting on any program this year because they don't want to be the bad-news people. Because they're immediately, whatever they do, they're going to be beat up by their opponents.

It is a political inclination to resist rather than suggest alternatives, because a) your alternative may not be very good, or b) it may not be very pleasant. I've been guilty of that kind of political tactic myself, of not showing a— And if a person as perfect as I am could do it, just think of what normal humans' temptations might be.

With respect to the president being a uniter, when he began, he was, at least on the education matters. John and I are very hopeful that he will be again on tax reform, because there we'd hope that we'd have a subject where both parties might have some modest investment they'd like to protect and not try to make each other look bad, but to try to look like they were groping for solutions. Maybe that's our next best chance to find areas of compromise and real discussion.

SENATOR BREAUX: Bill—and I interject really quickly on this—is absolutely correct about no one wants to make a proposal because they know as soon as they make the proposal, the other side has something to attack. If I don't make a proposal, then they're not going to have anything to attack. And neither side wants to go first because they know what the results are going to be. And the real question, I guess, a bigger question, is how do we resolve this? How do we get out of this mess? I mean, we all know what's happened down there and it's getting worse, not better. The question is how do we get out of this mix that we're in or are we just going to continue facing each other off and not being able to accomplish anything?

The problem is not just the Congress. The problem is also us in the private world. Because we all take sides and we take positions. We're right, they're wrong. And one side says: No, hell, we're right, you're wrong, and the other side's saying the same damn thing: We're right, you're wrong. But I think that there's a growing feeling among people—I was in a group last night that was a very business-oriented group, probably mostly all Republicans. I mean, there was a consensus there. They were unhappy as hell with the inability of the Congress to reach legitimate compromises even on things that they really felt very strongly about. Said, look, I'd rather have half of it than none of it. What I got now is none of it.

It's going to take the American public, and I think there's a growing group of people in the center that are saying, God, the only thing I see is both sides fighting all the time. Maybe we ought to have some kind of a center out coalition that says, look, we've got to force these people to get together so we can come up with at least some movement on the serious issues facing today. How long are we not going to do anything on health care because we stare each other down? How long are we not going to address Social Security because nobody wants to even make a proposal? It's going to have to come, I think, from the American public telling Congress what to do.

MR. GALE: Do you think it would help if the Democrats had control of one of the houses? Would that then engender more—?

SENATOR BREAUX: One of my great fears if the Democrats gain control of the House, they'd spend the first to Congresses just beating up on the Republicans for them beating up on the Democrats. By golly, we're in charge now. That's what happened the last time. I mean, Newt and they came in, they spent most of their time beating up on Democrats because they said Democrats beat up on them. So then if Democrats came back in, I fear that they'll say, well, we're in charge now and we're going to show you what we're going to do to you.

MR. FRENZEL: There's always about three bienniums of payback when things change. I'm not sure having divided control would be all that helpful, but clearly having one party gain a little greater superiority than two or three seats in the House, no matter which party it was, I think would be really helpful. When I was in the suppressed minority, occasionally John and his friends would throw me a crumb mainly because I wasn't a threat. But now everybody is a threat when you're evenly divided.

MR. GALE: All right, let's turn to questions. Please use the mike, please identify yourself, please keep it short, and please be sure you have a question.

SENATOR BREAUX: And no tough questions.

QUESTION: I'm Howard Silver from the Consortium of Social Science Associations.

It seemed, I guess it's 13 years ago when the budget deficit was about where it is now, I guess. It took sort of a crazy little guy out of Texas with a lot of money to wake up the American people to force the politicians to deal with the crisis then. Do you foresee any third force arising out of somewhere that would wake up the Congress and the executive branch?

SENATOR BREAUX: I think it's very difficult to have that. I mean, that little guy from Texas happened to be a multibillionaire and he had the resources to do that. It's very difficult to have the bloody pulpit unless you have the financial wherewithal to put together a forum to deliver that middle message. If you're not part of an existing political structure of being a Democrat or a Republican and having the party structure behind you, unless you're uniquely individually wealthy enough to do that on you're own. So I don't see that. I mean, the history of third-party efforts, and going back to John Anderson, and then Ross Perot because of the uniqueness of his financial condition, I don't see it out there. I think if you had that type of attractive alternative person that could deliver that message, that they could become very, very popular.

QUESTION: I'm Van Ooms from the Committee for Economic Development.

My question is from either or both Senator Breaux and Representative Frenzel as members of the tax commission. The tax commission has a mandate from the president that its recommendations be revenue-neutral. So the implications of that are that revenues would basically follow the low revenue line at sort the current percentage of GDP which was in Alice's graphs. I think it's very hard for a fair-minded person to look at the data in Alice's graphs and in this book without concluding that some degree of tax increase in the future is going to be necessary in order to get to not necessarily the high-government option but sort of any kind of option in-between.

So my question is how does the—and the work of the tax commission, as I understand it, is meant to be long-term, in other words, not some kind of a short-term fix. My question is how does the work of the tax commission, as you see it, relate, if at all, to a future where taxes are going to have to go up above this baseline?

MR. FRENZEL: Whether that happens or not is really not in the purview of this particular panel. The president has given us a number of strictures. One is that we accept his baseline, which keeps the tax number under, I think, Belle and Alice's lowest scenario at least for the next 10 years. And we have to be budget-neutral and we have to preserve charitable incentives and homeowner incentives, et cetera. But our job is to reform the code, not to say whether it's going to go up or down or what's going to happen to it in future years. And so that's the task to which we're going to bend our efforts. And if the president or if the Congress has some thoughts about where those tax levels should be in the future, that's where those decisions are going to be made. We're not going to make that decision.

SENATOR BREAUX: Let me just comment. The charge of the commission is really sort of tightly drawn in the sense that we have to make recommendations to simplify the tax code, we have to bear in mind the importance of home ownership and charitable deductions, we have to assume that the tax cuts of '01, '03, and '04 are made permanent, we have to have a recommendation that is pro-economic growth, reasonably progressive, and it has to be revenue-neutral.

Now, I had, in trying to find some Democrats to come and make presentations to the panel, and I'd outline that agenda and what our charge was, they say, Say what? You can't do that. I said, Well, you know, please come tell me we can't do that. I need to have somebody say that you are impossibly constricted with the outline that you've been given. You can't do all those things and still be revenue-neutral. I mean, that's a hell of a challenge. Are we going to do some recommendations on alternative minimum tax? I think everybody thinks we ought to, that it's gotten totally out of kilter as to what it was originally intended to do. But if we do away with it, it's $1.3 trillion over the next 10 years. Where do we find $1.3 trillion? It's got to come from somewhere. We look at a combination of income tax/value-added type of consumption tax that could generate some revenues which could be used for entitlement programs, I mean, that's probably within the purview of the commission's recommendations.

I hope the commission finally makes some bold recommendations because I think clearly the president would like us to make bold recommendations because that would give them more flexibility in picking and choosing what they want to utilize of that recommendation. And if you start low, it's just going to keep getting lower as far as boldness. So we came up with a pretty high, I mean in terms of boldness, recommendation about alternatives. Then they can factor in what is politically doable, and then they send it to Congress and Congress probably further reduces it. So if you want to come up with something good, you have to start really high, in my opinion.

QUESTION: Gary Mitchell from The Mitchell Report.

I want to ask what is arguably a rhetorical question, but it seems to me that if there's a lesson here today it's that notion of restoring fiscal sanity is secondarily a fiscal challenge and primarily a political challenge. I guess the question to the two panelists is do we need a companion volume on restoring fiscal sanity that looks at issues like redistricting and lobbying and/or congressional reform? And campaign contributions.

MR. FRENZEL: I believe that that is a correct interpretation. I think the book sets out what is basically fact. There are conclusions, but the conclusions, I suspect, would be pretty generally accepted by most people. The political system is resisting making decisions such as the book believes are necessary. And yeah, I can think of a lot of great ways to change the political system. However, most of them are constitutional amendment and they're rather difficult to impose.

But yeah, I think some kind of—well, maybe we have the beginnings of a redistricting solution arising in California, where the governor has some sort of a ballot initiative. There are three or four of those around in various states. But if California were to accept what I suspect, they would become the dish à la mode and other states would go there, and that would be helpful. Everybody laughed when I supported term limits, but that's an important element, I believe, too. Maybe that will rise again, but certainly not in the predictable future.

And there are other things. The best medicine of is an outraged republic. And I wish—I hope that everyone in the country would have a nice chance to study this book and then decide whether they personally are getting the kind of representation they deserve.

SENATOR BREAUX: I agree with all your recommendations except those affecting lobbyists.

[Laughter.]

QUESTION: David Dickson, Washington Times.

Throughout the '60s, '70s, and '80s, when the Democrats controlled the House, the reelection rate among incumbents was always well over 90 percent. And the Republicans had blowouts in presidential elections in '72, '80, '84. And Mr. Frenzel, you never came close to becoming a chairman of a committee. Why all the concern about incumbency reelection right now, when Republicans have 232 seats? I don't recall Brookings being concerns about 90 percent incumbency reelection rates in the '60s, '70s, or '80s.

MR. GALE: Well, I was in elementary school back then, so I'm going to defer to—

MR. FRENZEL: Okay, that was the prime of my life, so I will try to answer that. The Republicans, I think, cared rather deeply for challengers and tried to undermine the supremacy of incumbents all the time that I served in Congress. Normally we were playing defense, because, as you pointed out, I was chairman of nothing—ranked with but after the elevator boys over in the Capitol. But mainly we tried to do it by preventing incumbents from maintaining all the advantages they had. Usually, we tried to do it through the election laws by not allowing limits to be set on what challengers or any candidate could spend. But we didn't have the ability to push those programs very hard.

I think it's not quite fair to say that Brookings doesn't care, because Brookings has taken the opposite point of view from mine basically and suggested we need more restraints on election laws and so forth. And that would be helpful. I don't think that's the right way to go, but I don't think Brookings has ignored the question.

SENATOR BREAUX: I'll just make a comment. I think incumbents will always have an advantage, particularly if they're doing a good job. It's a disadvantage if you're doing a bad job, because you become a target. But Congress has tried to restrain that over the years, in terms of the caps on contributions. That supposedly is a way of slowing down the advantage that incumbents have in raising money.

But I think the big difference today from then is the structural difference of the congressional districts. I mean, even back when incumbents were winning back in the '70s, I think the districts were still more competitive than they are today because they hadn't been gerrymandered to the extent that they are today. The trend today is even much, much greater from a structural standpoint making it safe for incumbents than the advantages that they had back in the '70s. Incumbents will always have an advantage if they're doing a good job because, you know, they have the bloody pulpit to talk about their accomplishments. But now it's a structural difference.

MR. GALE: Susan?

QUESTION: I want to link a little bit about what Mr. Dickson said but also the point that, it seems to me, in a way you guys are talking about a really depressing decline in leadership. Because I'm old enough to remember when incumbents were reelected, but it was the safe incumbents who were willing to deal. I mean, it's exactly when you think you can take risks that you should be willing to meet with someone who disagrees with you and go home and explain to your constituents, because you got a little margin. So I hear you all talking about safe incumbents unwilling to deal, and I want to know what happened that now safety becomes equivalent to I don't move at all, I don't go home and tell anyone I think they're wrong. I mean, you're dumping it all on the public, but whatever happened to the obligation to lead?

MR. FRENZEL: I think there is a strong obligation to lead, as I've already suggested. I already mentioned also that, because of the districts being strongly Republican or strongly Democrat, the principal challenge comes in primaries. The primary voters tend to be the extreme voters. And they tend to make members more willing to follow the positions of the extreme voters, which is: don't compromise, take only my deal, and object to all others. So, yes, I suppose that we would be delighted if Edmund Burke were elected to all 435 voting districts. But that, unfortunately, has not been the way our system works.

SENATOR BREAUX: Well, a lot of members, though, think they're leading by representing the majority of the people in their congressional districts. And if the majority happens to be clearly one way or the other, they don't have to deal with the other side. My obligation, they would conclude, is to represent the majority opinion. And that's relatively safe. It's very difficult when you reject the majority and side with the minority. You'd better be pretty swift of feet and sound of mind to be able to do that and still get reelected. Now, a lot of them will take the safer position of just saying, look, I'm just going to represent the majority, I don't have to deal with anybody else's views, and I'm leading the majority and that's what I'm supposed to do.

QUESTION: But if they want certain things that can't add up—don't cut my benefits and don't raise my taxes.

SENATOR BREAUX: Yeah, but then they still get reelected because that's what the majority in that district is advocating, unfortunately.

MR. GALE: Right. So we are at the end of our time. I hope you—

SENATOR BREAUX: Oh, we're just beginning to have fun.

MR. GALE: Fun in a weird Washington kind of way.

[Laughter.]

MR. GALE: Let me thank both panelists for a very stimulating discussion.

[Applause.]

Social Security, Health, and Taxes

MS. SAWHILL: Okay, we're going to get started again. We've got a terrific panel here of our authors to talk in a little more depth or detail about the substance of the book. This book is really built around the chapters that they all wrote. There are two authors who are not here, John Shoven from Stanford University and Rudy Penner from the Urban Institute, but all of the rest are here.

I'm going to start with Peter Orszag on Social Security, and then we'll move to health care with Henry Aaron and Jack Meyer, and we will then do taxes with Gene Steuerle and end with further comments on the political situation from Ron Haskins, following up very much, I think, on the discussion we just had with Frenzel and Breaux.

Without further ado, then, let me turn to Peter.

MR. ORSZAG: Thank you, Belle.

As Belle mentioned, I co-authored this chapter with John Shoven of Stanford University, who is a very, very strong proponent of having individual accounts as part of Social Security and I am someone who thinks that that's not a good idea. So the way in which we framed the chapter was to identify things that we agreed on so that we could crystallize the debate over what areas were sources of disagreement. I think in the rhetoric back and forth on both sides of the debate it would be easy to think that there aren't any areas of agreement, and yet we were quickly able to reach many, many areas of agreement and then pinpoint areas of disagreement.

So what did we agree on? First, we both agreed that acting sooner rather than later would be preferable. And the main reason for doing that is to avoid jarring changes to benefits that are already in force. So just to get some sense of the magnitudes involved, if you wanted to eliminate the deficit entirely on the benefits side—and I'm not proposing that—but if you wanted to eliminate the deficit entirely on the benefits side today, it would take a reduction of about 15 percent to eliminate the 75-year deficit. If you waited until about 2040, it would take about a 30 percent reduction. That assumes that benefits are reduced not only for younger workers, but for people who are already on the benefit rolls—in other words, an 85-year-old who had been getting $1,000 a month would also get a 30 percent reduction. If instead you wanted to protect current retirees and those on the verge of retirement, if we waited until about 2040, it would require a 70 to 90 percent benefit reduction for everyone else.

That makes the point. We would either be imposing undue burdens on younger workers at that point, or, since those sorts of reductions aren't politically viable, be forced to reduce benefits for those who are already receiving them. That's not desirable. It's better to act sooner rather than later so that we can spread the necessary burden.

The second thing we agreed on was that we shouldn't have any gimmicks involved in Social Security reform. It's unfortunately become quite common for plans to have a lot of them, in which you make it look like the Social Security deficit is addressed only by transferring trillions of dollars of resources from the rest of the budget, which, as you'll hear from other panelists, faces its own significant deficit, which is akin—the analogy I like to draw is that my 5-year-old daughter likes to pretend that she cleans up the pile of clothes on the floor of her room just by sweeping them under the bed. Of course, that does not actually clean anything up; it just hides the mess. Same thing here. You shouldn't pretend to fix Social Security by hiding the mess.

The second gimmick, in addition to general revenue transfers that are out of a budget that's already in deficit outside of Social Security, is to play off the higher expected return on stocks compared to bonds without taking any account of risk whatsoever. The Congressional Budget Office, to its great credit, in scoring Social Security plans, does not award any credit for that kind of game-playing. And both of us agree strongly that that is the way that the analysis should be done.

The third thing that we agree on—and it's sooner rather than later, no gimmicks—the third thing is that we should raise national saving as part of this reform plan. That's really tied to the no gimmicks. One way of looking at the problem with those gimmicks is that they're ways of making Social Security look like it's on firmer footing without actually raising national saving.

Two further points of agreement, that we should preserve some base tier of income that is provided on a lifetime basis and that's protected against inflation. Of course, the big debate is, okay, how big is that tier, though we both agree that there should be some solid tier along that dimension. And then finally that, in reforming the program, we should protect the most vulnerable beneficiaries; in other words, the reform should be a progressive one in which the bottom end of the income distribution is protected.

So what do we disagree on? We disagree on two key points. One is whether reforms that are done through the traditional system that build up a somewhat larger trust fund would contribute to national saving and would reduce the overall budget imbalance. John believes that they would not; I believe that they would. And we discuss that in the volume.

And then we also disagree, as I already mentioned, about whether individual accounts should replace part of Social Security. John believes that they're useful as a political sweetener for the necessary changes to restore solvency to Social Security, but emphasizes that they do not, as the administration has emphasized, that accounts do not contribute directly to restoring solvency whatsoever. He just views them as a sort of political sweetener to make the changes that are necessary go down easier.

I think that they actually aren't a sweetener because they're effectively a loan to workers, and so there's no sweetness there, and that what we should be doing is taking the accounts that we already have, 401(k)s and IRAs, and making them work a lot better. And by the way, John agrees with that also. He just thinks accounts belong in both places.

So even within those areas of disagreement there are some areas of agreement. I had mentioned that John, like most honest proponents of individual accounts, admits that they do not directly solve the imbalance in Social Security and they don't contribute to reducing the deficit. So we emphasize that basically given that, the only choices you face are whether you're going to reduce benefits or raise revenue. It's that simple. And we have a table in the book, Table 3.1, which just walks through various options for benefit reductions and revenue increases. We disagree on the relative mix. John is more willing to do more of the lifting on the benefit side; I'd rather attenuate the necessary benefit reductions by dedicating some additional revenue to Social Security. But we agree that those are the only two types of changes that will actually restore long-term balance to the program.

So I was particularly encouraged in writing this. I have to say I was hesitant at the beginning because I had known about John's policy preferences and thought that it wouldn't be a particularly productive endeavor to try to co-author a chapter with him. But as it turned out, there were so many areas of agreement that this has actually been quite a positive experience.

I would hope, but I am skeptical, that the broader policymaking community could adopt a similar attitude and find the areas of agreement, and in particular find the honesty and the courage to step forward and examine the benefit and revenue changes that are required while being forthright about what accounts do and don't do. I hope that's what our chapter achieves.

Thank you.

MS. SAWHILL: Thank you. Henry?

MR. AARON: If James Carville had written the book that we're discussing today, I think it would have been entitled, "It's Health Care, Stupid." The reason I say that is encapsulated in Table 4.1, which was distributed to you and is in the book. It indicates that if historical trend rates of growth of health care spending continue, then Medicare and Medicaid alone will claim an additional 12 percentage points of GDP by the year 2030. That's above what it costs today.

To put that in perspective, that's about 50 percent more than the entire personal income tax yields today. Also to put it in comparison, over that same period of time the cost of Social Security is projected to rise by about 2 percentage points of GDP.

Total health care spending, not just Medicare and Medicaid but the private sector as well, is projected to claim about a third of our entire gross domestic product by the year 2040 if trend rates of growth of health care spending continue. Health care will claim half of all economic growth, all increases in income by the year 2022—again, assuming historical rates of growth continue.

Jack Meyer and I discuss a number of ways by which the rate of growth of health care spending could be slowed. To encapsulate the overall story, the general verdict is many of these ideas are good ideas. Some of them would actually save some money. None of them will suffice materially to slow down that rate of growth by itself. Let me give a couple of examples.

Malpractice reform is much under discussion today. We suggest that the impact of malpractice reform overall on health care spending will be small enough so that the effects would be hard to detect in the numbers. The direct costs of malpractice are quite small. There are allegations of and some evidence to support the existence of defensive medicine, the unnecessary care that provides little benefits but really isn't worth what it costs.

We report a number of studies that acknowledge that too much care is provided to a number of patients, but those same studies indicate that a far more serious problem is the under-provision of care, the care that isn't prescribed that it known to be medically beneficial. More accurate targeting of medical services is certainly desirable, but it isn't clear that a more targeted system will be less costly than the one we have today.

Raising the age of eligibility for Medicare. By itself, if that were the only instrument used to slow the growth of Medicare spending, it would be possible to slow the growth of Medicare spending so that per capita Medicare spending grew no faster than income. How? By raising the age of eligibility for Medicare in the year 2030 to age 79, and by raising it in the year 2040 to age 83. Small increases in the age of eligibility may be on the agenda, but that, too, is not the answer to rising Medicare costs.

This problem is not solely fiscal. Health care costs will be rising in the private sector as well as in the public sector, squeezing compensation that workers could receive in other forms and creating labor-management unrest in the process. What that means is that the solution to Medicare and Medicaid should not be treated entirely as a fiscal problem. It is a health care financing problem that requires system-wide reform.

And at the risk of injecting a small bit of politics into this otherwise studiously bipartisan session, I want to suggest that if we were to, in the name of the fiscal problem we confront, slash Medicaid and Medicare benefits at the same time that we sustain tax cuts disproportionately accruing to the wealthiest 1 percent of the American population, we would be giving the term "compassionate conservatism" a truly twisted meaning.

Thank you.

MS. SAWHILL: Jack?

MR. MEYER: Thank you. About 20 years ago I clipped a cartoon in the height of that budget crisis that I think encapsulates the problem we face today. The cartoon had a Coke machine, and on the Coke machine it said "Free Tax Cuts." And then down at the coin slot it said, "Please deposit grandchildren here." I think that's the problem we face, and we need to rewrite the social contract generally in our social insurance programs, but particularly in the health care area.

The model we have on the table, people work for 30, maybe 35 years, draw down benefits for 10, 20, at some point 30 years, almost approaching balance if you get the kind of breakthroughs in longevity that we see. I don't think that model will work. The model that all pay the same for benefits regardless of ability to pay, can't raise taxes, don't touch mom's benefits—this is the political wisdom out there, and it won't work in health care, I'm sure.

Congress and administrations Republican and Democrat try to wrestle with the problems of Medicare by a strategy that I would call death by 1,000 cuts—let's cut back the docs' rates a little bit; oh, they come back and lobby for more. Well, then, maybe we can cut the hospital DRGs—lobby for more. Maybe we could get the labs—

[Change tape.]

MR. MEYER: —shortfalls that Henry has alluded to. Yet one side says let's cap the programs or voucherize them or even privatize them. I don't think that's the answer. But the other side ducks for cover and, as we heard this morning, says your idea's a bad one, but no, I don't have a better one, even if the idea on the table is a bad one.

So how can we rewrite the social contract in health care? Well, it seems to me, if everything is on the table, if no one variable takes all the burden, so tax rates, payroll tax rates have to be on the table; the premiums that people pay have to be on the table; the age of eligibility has to be on the table. Clearly we're not going to raise the age to 83. We're not going to slash benefits—I don't think. We're not going to put it all on taxes. But maybe if we sat down and tried to come up and cobble together some mix of benefit, tax changes, age changes, we could do it. So what we need also is an inter-generational compact. We can't put it all on seniors, we can't put it all on taxpayers.

Let me just tick off a few things that I think might help get us out of this mess.

First of all, I think we need incentives for people to work longer, and that could be tied to increasing the age, in stages, of eligibility for a program like Medicare. You don't do that for someone who's 64 today, but we could do it the way we did in Social Security 22 years ago—announce that for the next generation we'll begin edging up that age. And take steps in the public and private sector to try to create incentives for people to work longer. The age of 65 just won't cut it, in my view, and I think we'll probably have to look at something like 70 for the next generation.

Second, asking a greater contribution to programs like Medicare for people who have the ability to pay. This is not means testing. Everybody should be in Medicare. But it may just be the case that someone like Bill Gates, when he retires, won't pay the same $80 or $90 per month Medicare Part B premium—whatever it is then—as a little old lady living in a cold-water flat on only a Social Security check. I don't think that's draconian. So we might also have to look at the deductible as well as the premium, the deductible in a program like Medicare Part B, which hasn't been increased much over the 40-year history.

Third, the payroll tax might have to be notched up a bit over time. There's nothing magical about 2.9 percent. Can't put it all on that, but both benefits and taxes have to be on the table.

Fourth, we have to reduce inappropriate care and recognize that Medicare has great opportunities to save some money. Not that it will get us through, as Henry pointed out, but we know from studies of Medicare that the program spends twice as much in cities like New York and Miami as it spends in places like Minneapolis or Seattle. You can't wave a magic wand and change practice patterns of a Miami physician and make him or her like someone in those other cities, but you can reduce inappropriate care. And, really, invest in technology—it will take a huge investment—and try to reduce unnecessary care.

Finally, I think we have to learn how to better assess advanced medical technology; this for Medicare and the whole system. I don't favor controls on technology or drying up the pipeline, but we need to figure out what medical innovations work and for whom, what is cost-effective, what is clinically effective, and adjust our payment systems, public and private, to pay for care that is effective based on clinical guidelines.

At the end of the day, we're going to have to make all these tough decisions. There's no one thing that will get us through. We hope that we've made a little contribution to framing the debate.

MS. SAWHILL: Thank you. Gene?

MR. STEUERLE: Thank you, Belle.

Bill Gale and I tried to put a lie to the rumor that economists were simply accountants without a sense of humor. So we got to write the tax chapter, which is always very exciting reading for most people.

In some ways we had the hardest task and in some ways the easiest task of all the authors. It was the hardest task in the sense that when it comes to talking about size of government, it's often on the tax system that people focus their attention, so that as soon as you talk about raising taxes, they immediately want to protest that that's going to happen because in fact that's recognizing the cost of government—or, if you want to quote the Supreme Court judge, Oliver Wendell Holmes, Jr., it represents the price of civilization.

So that was the hard side of it. But in some ways, there's an easy side to it that Bill and I argued, which is basically the tax level of the government is basically set by the expenditures that it incurs. And you could argue that, well, temporarily you might lower taxes below expenditures, but that's a little misleading, too, because once we've spent the money, we have to raise the taxes to pay for it and it's just a question of whether we're deferring paying those taxes as well as the interest we might owe on the deficit in-between.

So in that sense, Bill and I really didn't have to fight too much over level of government because in some ways that was sort of determined by the other chapters, in terms of what expenditure they talked about. Once we had that level of government set so much by expenditures, we got to talk about what do you have to do to the tax system in order to bring about a reasonable balance. And we presumed, since we're talking long-term, that balance was at the level of expenditures—again, with the notion that if you run deficits, that doesn't get you very far because that just raises interest rates and raises taxes in the long run anyway.

I mean, as one example, the biggest tax increase we've had in the last few years was the Medicare prescription drug bill. Because we didn't pay for it, we're spending more, and that's an increase in taxes, just as if the household went out and spent, you know, $10,000 and borrowed $2,000 to do it, we don't say it spent $8,000. It spent ten, and it's got to come up with the $10,000.

So once we have these various levels of expenditures set—and there's the small government, the large government, and the social contract government in the book—what are the ways we can deal with the tax system to get there? In some ways I'm not sure it ended up to be as hard as we thought it was going to be. Essentially, there are three general areas in which you can talk about — taxes. You can talk about the tax base, you can talk about the tax rates—those in the income tax, and you can talk about alternative taxes.

When it came to the tax base, Bill and I were in fair amount of agreement. There were a lot of improvements one could make in the tax system; there were a lot of subsidies in there that were not well-functioning. If I can go back to Henry and Jack's area, which I often go to—and Senator Breaux represented this issue as well—the so-called exclusion for employer-provided insurance that's provided to employees is so inefficient that at the margin we're spending tens of millions of dollars more every year. If you add it up over a number of years, you're spending $50 million more in the future. That additional 50 million that we'll spend annually for that exclusion, that additional amount is probably increasing the number of uninsured. We're spending more to buy more uninsured people. It's that bad of a subsidy.

And we could go on with other areas of the tax system. I can explain why later, but it's largely because it's open-ended. It's not just encouraging people to buy more insurance, it's encouraging them to buy expensive insurance, which raises costs, which denies the uninsured.

But we could go through other areas of this. And we suggest that in fact one could get at these tax subsidies. But mind you, going after these tax subsidies is equivalent to what the other authors are often talking about when they talk about cutting back on expenditures. I mean, cutting back on subsidies hidden in the tax system is often equivalent to cutting back on expenditures in the direct system. Not always, because the programs differ. It depends on the nature of the program. But it's, in that sense, a very conservative type of policy. It allows you to have smaller government. Maybe it doesn't show up in the average tax rate, but it shows up in the statutory tax rates that people have to pay either in the tax system or in this crazy alternative minimum tax.

So we suggest that there is substantial room to go there. And you could draw up to, we argue, as much as 2 percentage points of GDP, probably, going after these tax subsidies. I say, dodging the politics, one could find ways to cut back on a variety of these subsidies because many of them are very large, on the order of $70-100 million a year each.

The second thing one can do, of course, is to address tax rates. In the short run, one could defer or delay or simply cut out the tax rate cuts that will come about if we extend the tax bills that were passed from 2001 to 2003. We also suggest, if you're willing to do other things along the way, in the long run you might be able to cut back tax rates too. And that's partly because, unbeknownst to most people, there is this constant tax rate increase actually coming along anyway, which is bracket creep. We often associate bracket creep, or moving up to higher tax brackets, with inflation increasing income. But in fact if you carry these systems out 10, 20, 30 years into the future and average real incomes go up, average rates go up there as well. That actually leaves some leeway to actually cut rates if you have smaller government. As I say, you can also increase rates if you want to go to larger government. Or you could keep rates about where they are.

Mind you, a few years ago we were collecting 20 percent of GDP rather than 16 percent with our current tax system, with basically the same current base, although some of that had to do with a stock market bubble. But still, it shows you that even in the current system we certainly have had rates that would allow you collect revenues at that level.

The final area we address is the question of whether one wanted to think about a new tax. And I think we pretty much laid to rest the notion that one can go to certain tax systems like a retail sales tax. It just doesn't work administratively, and you can read some of the details in the chapter. I mean, Bill and I both testified, but we testified along with Bob Hall, who's considered a very strong consumption tax advocate. He's one of the authors of the Hall-Rabushka so-called flat tax. He said it doesn't work, we said it doesn't work. It doesn't work for a variety of reasons, including the fact that you'd have to hire tens of thousands of dollars of extra personnel at the borders to try to make sure we all paid our 40 percent tax rates for the retail goods we brought in over the border. And that's just the bare end of the story.

The tax system, if you're going to go towards a new tax system that does work, that's incorporated indirectly in a lot of proposals—in other cases more directly—is something that's based on a value-added tax base. It's adopted by many, many countries around the world. And the simple fact that it's been adopted by so many countries makes it a lot easier to deal with border adjustments and a lot of other things that are very technology, but very complex. You could do it a lot more simply and a lot more cheaply because we have examples out there that work. And there are reasons why a value-added tax, by the way, has very good enforcement mechanisms in it. It has, indirectly, ways of capturing tax from you if I don't pay, in some cases.

So in the end, what we suggest is some combination of all of the above—changing the tax base, going after the tax subsidies, possibly addressing tax rates, possibly adopting a new tax, especially if you go towards a much larger government—that eventually will bring about the revenues you need to pay for whatever government we have. Let me be clear about it, we did not agree on what size of government we might like and where we'd like that government to go. But we could agree that the revenue system had to be there to pay for whatever government we had.

MS. SAWHILL: Thanks, Gene, and congratulations to all of you for staying within your time limit. Ron?

MR. HASKINS: I'm going to break that tradition. Well, I have only two problems as I sit here. The first one is that I'm last and everything has already been said. I have absolutely nothing to add to what's already been said, but as Tom Downey once said to me about debates in the Senate, not everybody has yet had a chance to say everything that's been said. So now you get to listen to me repeat what's been said.

And the second thing is that we've heard an unbroken litany of tragedy up here, and gloom, and I would dearly love to say, oh, no, that's wrong, look at all these—but I can't, so I'm going to continue the gloom. Those are my two problems.

Bill and I had the idea that we ought to put something in this volume about politics, because, after all, we could have all these brilliant ideas that we dream up sitting around in these think-tanks but unless someone actually puts them into practice, you know, the ideas are no good.

So then we had another brilliant insight which was, well, maybe we shouldn't sit around talking to a bunch of scholars. Maybe we ought to go out there and, first of all, look at what's already happened, and look at history, and then secondly, let's talk to people who were directly involved in that history and ask them for their views of the factors that really contributed, made a difference in the deals of the past.

So, first of all, this is, you know, somewhat new, and it may be even a little optimistic, and that is, we have made deals in the past on big items that face the country and were done fairly successfully, and if you look at that handout that you have, you will see five of them. The Social Security reforms of '83 that have been mentioned here a couple times. The tax reforms of '86 and then the budget deals of '90, '93, and '97.

And on a ten point scale, I think they all get at least a four, maybe a five or a six. I mean, they're not perfect. People objected but, you know, it's a lot better than a zero. So let's look at these and see what the factors were.

So the first thing we did with the help of Steven Robley [ph] who's in the audience here, was we looked at press accounts and even some scholarly accounts of what happened, and we found a number of factors that people said really contributed to those previous deals, and those are also listed on your handout. They're called "Important factors in achieving budget compromise:" external threat, president leadership, bipartisan support, and so forth.

And then we decided that we would take these items and some others, and ask the people who had participated in these and other big negotiations and big compromises that the Congress reached, and ask them what they thought of these factors. So we identified 20 people, half Republican, half Democrat, some of them extremely prestigious people like Tom Downey and John Kasic, Bob Reischauer, Bill Frenzel. Even Dr. Ooms out here, we talked to. So we talked to quite distinguished people who have a lot of experience in these matters and we asked them what they thought, and surprisingly, there was quite a bit of agreement.

The first thing they agreed on was that three factors really were important and sixteen agreed on two of these and thirteen on one of them, and no other factor had no more than three votes. So there was really quite an agreement, and the three factors are an external threat or a pressure that's forcing Congress, the clearest example, one that almost everybody mentioned was the Social Security system was about to run out of money. So Congress decided, as Bill Frenzel said, to wait till there was 30 days left and then they would do something.

Secondly, presidential leadership was mentioned by sixteen of 20 people we interviewed, and third was bipartisan support. So if these are the three factors that are really important, then I ask you, based on what you heard here this morning: Do you see any evidence that any three of these things are about to occur?

Now Bill and I, being quite brilliant, anticipated that something like this might happen and that people we interviewed might be a little pessimistic about the probability that, you know, by the end of this session, that we were going to have agreement on how to solve the budget deficit.

So we anticipated that taxes might play some role here, and we asked our interviewees, What about taxes? What do you think are the probabilities that we will actually get some tax increases? Because every one of these deals, in the past, not only was it a bipartisan spirit that was talked about on the first panel, but also the actual agreement was bipartisan. Both sides got something out of the agreement.

MS. SAWILL: And the wording was over the next few years, not just this year; right?

MR. HASKINS: Oh, yeah. It was in the near future, is the way we phrased most of these questions.

So we asked it in three ways. What do you think is the chance that a majority of Republicans in Congress would agree to a tax increase, other than some really teeny little thing? And secondly, what do you think is the probability that a minority of Republicans but a substantial minority, that we could do the old "blue dog days," if you remember that, that moderate Democrats and moderate Republicans could work together and achieve some kind of solution, and what's the probability that President Bush would accept a tax increase?

And the answer in all three cases, in either 18 or 17 observers, was "No way. There won't be any tax increases." So this adds further to the gloom. But we anticipated this as well, and so we decided, well, those Republicans, they're pretty daring. Giants walked the Earth in '95 and '96, they passed legislation—some of you may have forgotten this—which cut a trillion dollars in spending.

So can they do it again? And we asked them, can Republicans cut spending? Will they cut spending? Will Republicans vote to cut spending?

And in this case, 15 of the 20 people interviewed said, "Oh, yes," but less than one percent of the budget. One percent of total spending.

So that's about $24 billion in a huge budget, and no one thought that Republicans would cut more than about 2.5 percent; certainly under 3 percent. So even action on the spending side is not to be anticipated any time soon.

So I conclude from all this that, as Bill Frenzel said on the first panel—you might not have noticed this—but Bill Frenzel always has the right answer. I learned that when I worked for him on the Ways and Means Committee, and if I didn't learn that, you'll never know I didn't learn it.

And the answer is the last hope in a democracy is the public. Now, unfortunately, in this case, there also is very little evidence—we looked at the poll data—that the public is very alarmed about this, because apparently, they really like it if they can get a lot of benefits and not pay taxes.

So I am left with this and I'm going to quote Surgeon-General Koop. He had a wonderful saying about some health problem. Well, he said, we're now in crisis but no one is gonna do anything until we enter chaos.

MS. SAWHILL: Very good. Thank you. Okay. The floor is open. Yes?

QUESTION [off-mike]: I've been hearing more passing references to [inaudible] and I'm sure Alice at least is familiar with John Podesta's campaign [inaudible].

MS. SAWHILL: Center for American Progress.

QUESTION: Center for American Progress.

[inaudible] a value-added tax that would be dedicated solely to health care, I would propose making a dedicated authority to health care and Social Security, and doing away with the payroll tax [mike comes up], because while the value-added tax is regressive, getting rid of the payroll tax would be very progressive, and there's maybe a deal-breaker. Both sides—the Republicans could get their nose under the tent with a value-added tax, the Democrats could get rid of the payroll tax, and I'll quote John Kenneth Galbraith from his 1958 "Affluent Society."

He says: It's more important that we get the revenue than that it be collected progressively, because otherwise we don't have the programs.

MS. SAWHILL: Well, I don't know. I think maybe Henry should go first on it.

MR. AARON: I was just going to remind everybody of the comment that Larry Summers made, some years ago, about why the value-added tax is not currently an American tax and what it would take for it to become one. He said the problem is Republicans think that the value-added tax is a money machine. Democrats think it's regressive. It will be adopted when Republicans realize it's regressive and Democrats realize it's a money machine.

[Laughter.]

MS. SAWHILL: Do you want to add something?

MR. : I'd just like to add, I think politically, I think it's very, very hard to make the type of transition you're talking about, but I don't disagree that, actually, there, at least in my view, that there would be merit in moving more towards a value-added tax than a payroll tax. I don't know so much that it's an issue of progressivity. They both tend to have the same degrees of issues. They're both sort of flat taxes, that at upper-income levels, people don't pay a large percentage of their income or their consumption in the tax, but it would actually address one of the issues which is indirectly in some of these things we're talking about, which is we're giving all these increases in things like health benefits to the elderly and we're sort of exempting them entirely from paying for them, including people like myself, who are over 55, who aren't supposed to pay for any change in Social Security or Medicare, anything else, even though being promised huge amounts of benefits.

So I think there's even some equity arguments in what you say. I wonder whether we would really go—what you're really talking about is far beyond a tax restructuring. You're talking about a restructuring in the very nature of Social Security too, the way it calculates who gets what benefits and a lot of other things.

MR. : If I could just add one thing, assuming the same base, the difference between the value-added tax and the payroll tax really has to do with how you're treating the owners of existing capital when you put the tax in.

So under a value-added tax or a consumption tax, if you own capital, you get hit by a consumption tax when you go out and try to spend the money.

That's the real difference between a consumption tax and a wage tax, like we have in the payroll tax. So the proposal is to move from a wage tax to a consumption tax for Social Security and health care, in other words, to impose a burden on existing capital there, and yet in the income tax, we're moving in exactly the opposite direction by providing windfall gains to the owners of existing capital by changing the tax treatment of capital that was different from when it was purchased.

So it would be strange, or an irony, or unusual, to provide windfall gains to the owners of existing capital in the income tax and then shift it to a tax that finances Social Security and health care and, in some sense, that would be the net effect of the proposal, combined with the changes that we're making in the income tax.

MR. : Could I just say something serious about this? The idea that we are going to do away with a tax that is currently yielding nearly as much revenue as the personal income tax, and thereby have to impose a really, really high rate VAT I think is just not on. We're going to need all the revenue sources we currently have, and more besides. So the message, I think, that emerges from this book, is that if we are going to pay fully for even approximately what current services promise in the future, we're going to need an additional revenue source, not as a replacement for current ones but on top of current ones.

MS. SAWHILL: As someone who has a lot of sympathy for the idea you put forward, I would agree, the numbers just don't allow you to go that way.

MR. : I will continue to put the burden on [inaudible].

MR. : Well, VAT does too. As Peter—

MR. : But not as much as the payroll tax.

MS. SAWHILL: Well, one of the ways not to put quite as much burden on the poor is to raise the threshold, which Peter has talked about quite a bit.

Van.

MR. OOMS: Van Ooms from CED. A question for Henry and for Jack. As Henry's already said, this is really about health care. I mean, it's the rate of growth of health care costs, for various reasons, that's driving the whole scenario. It's hard to get a sense as to how much that growth rate might be slowed, even if one did quite a long list of so-called good things, some of which Jack enumerated.

As you probably know, I mean, the sort of baseline you're using is the CBO's so-called high path, but it's really a historical path, actually, of 2.5 percent excess cost growth. Then they have what they call a middle path, which is way down to one percent, which seems to me to be a huge reduction in the rate of growth, even though CBO characterizes it sort of as somewhere in the middle, and they have a low path as well.

Can you give me any sense as to how much realistically the growth of health care costs—and I'm thinking systemically here, not just Medicare and so forth—but how much realistically, if we did a whole lot of good things like trying to get more prices into the system, into our third payer insurance system, and if we increase co-pays, and, you know, some modest changes in eligibility and so forth, how much those growth rates might be slowed?

MR. AARON: I cannot answer your question precisely. Maybe Jack will have a better sense. The way I would look at this is that as a nation, we now are spending probably, as of today, about 16 percent of our Gross Domestic Product on health care. The numbers you saw at 15.3, I think were actually for 2003.

Western European nations are in the 9, 10, now some are getting into the 11 or 12 percent range. They have fairly tight administrative mechanisms for restricting the levels of spending there that are budgeted to hospitals, limits on various other forms of payments. They have very large entities negotiating with health care providers.

I think it's reasonable to think that over a period of time, a long period of time, probably measured in like 10 or 15 years, we could end up where Europeans will be in 10 or 15 years, with respect to the share of GDP.

In plain English, I think that means that we could look at shaving a couple of percentage points off of the share of GDP, that we would otherwise be spending in the future, and we can expect the share of health care, as can the Europeans, to grow, for the reasons that have been mentioned, ad nauseam, today.

The menu of beneficial interventions is growing at a rapid rate. The average age is increasing, which tends to increase per capita spending, so that we're looking, I think in the future, at a steadily-growing share of GDP going to health care. But we could knock a couple of points off of that by the combination of interventions that are described in the chapter.

Instead of looking at a third of our Gross Domestic Product going to health care by 2040, I think it's reasonable to think it could be in the range of a quarter, somewhat, perhaps a bit more than that.

But what we're seeing now is a scientific flowering that is truly civilization changing in the way of health care technology. The benefits from most of what we spend are enormous, on the order of the benefits we've gotten from all economic growth in the past 30 or 40 years. That's going to continue, we're going to want to buy it; so are other rich nations. It's a question of how much, not whether the health care share continues to grow faster than GDP.

MS. SAWHILL: Did you want to add anything, Jack?

MR. MEYER: Well, I agree with Henry. I would just add that I don't think that the net reduction from all these things will amount to much. I think it's going to be at least 2.5 percentage points, maybe higher. I think you do get something out of raising the age. We show if you increase the age to seventy—

MS. SAWHILL: But Jack, is that because of offsetting influences?

MR. MEYER: There are offsetting expenditures on Medicaid and this is no panacea, and I'm just saying that I think, for the reasons Henry suggested, these increases will march on and they will exacerbate the number of uninsured. The more that costs go up, the more you get turn-downs by low- and moderate-wage workers. A recent paper forecast 56 million uninsured, if this rate continues.

And so I don't think it's a stable system. So I don't think we have time for all the investments in inappropriate care reduction to play out, which is a, you know, multi decade—we're going to have to make some tough choices.

MS. SAWHILL: I didn't actually mean offsetting in the fiscal sense. I meant in the sense that you could get some slower growth from point A to point B, if you reduced the level significantly, but offsetting that is the fact that technology may push above 2.5 percent.

MR. MEYER: Yes, and a lot of these changes are cost-shifting, not really cost control. You know, if I raise somebody's deductible, that kind a shifts the cost of Medicare from the taxpayers generally to that beneficiary, and the theory is that that will slow spending. I'm very dubious of how much that will slow spending. It could create a lot of hardship.

So a lot of these measures really aren't—there's a real difference between real economies and efficiencies in cost shifting.

MS. SAWHILL: Okay. Yes?

QUESTION: I'm Barbara Smith and I'm a health policy analyst. I was wondering if you could comment on two different things which Jack alluded to. One is the changes in Medicare that might increase the number of uninsured and how feasible these changes are in a context of not having universal coverage. And then the second thing that is just a factual point, which is are the European nations also facing significant deficits or are they coming into this period where their populations are also, you know, aging and becoming more expensive from a position of greater strength in terms of fiscal stability?

MR. : The last one's easy. I forget who it was who described a meeting with a finance minister in France, and this person was bewailing the serious fiscal problems that we face here in the United States. When he was done, the French finance minister said: Oh, my, you don't really have any problems at all. Let me tell you about the situation here.

The demographic situation in Western European is far more serious than our own. Our birth rate is much higher. Furthermore, their social insurance system, their pension systems, are vastly more generous than ours, so that they really, really have Social Security financing problems.

Next to the British, we have the smallest pension issues of any major developed nation on this side of the world. Australia is also quite small.

So from a fiscal standpoint, if we face a problem, the Europeans face a catastrophe.

QUESTION: The other part of the question was what is the impact of some of these reform proposals in the context of not having universal coverage, and would universal coverage, of whatever stripe, mitigate some of the impacts of these reforms or make federal outlays in some ways more rational?

MR.   : Well, I think that the upward march of costs, premiums in the private sector, public sector costs, will lead to cutbacks in Medicaid. That will exacerbate the number of uninsured. I've already indicated that the explosion of premiums that's been running at 13, 14 percent in the last few years, will lead to turn-downs which will exacerbate the problem of the 45 million uninsured.

So I see this problem getting worse and I think the United States has to debate whether to move toward universal coverage, either in a way that other countries have done it, or to try to cobble together a series of Medicaid expansions, children's program expansions, perhaps a tax credit as President Bush has proposed for people above poverty but still low, moderate income. Some kind of a purchasing arrangement for people to take their tax credit, for workers who make 25-, 30-, $35,000, maybe coupled with what Senator Breaux said this morning, an individual mandate, and he made it clear that for his individual mandate, which he proposed when he was in Congress, to work, you'd have to have a better subsidy system.

That would be the alternative. It's much harder and messier to put all those pieces together but much more American, and that seems to be the way we're approaching it.

There are some states experimenting with things like that, Maine being an example with its DERGO [ph] program. Other states are debating universal coverage.

The Congress is really not taken this up right now but there's a lot of interest in it in various states, and I think that's probably how we'll end up getting there, if we get there; some steps at a time.

MS. SAWHILL: Well, I don't see a lot more burning questions out there. You all have been very patient, we appreciate your coming. I want to thank all the panelists for their contributions, and some of the many people here at Brookings who worked hard to put this event together, Katy and Meaghan in the front row here, some of the people who helped with the book, Steve Robley and Nate Meeth [ph] and others.

So thank you very much and we hope to see you again soon.

[END OF TAPED RECORDING.]

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