THE BROOKINGS INSTITUTION

# TAMING THE DEFICIT: A BIPARTISAN PLAN

# TO BALANCE THE BUDGET

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P R O C E E D I N G S

MR. WESSEL: I am tempted to say we should rearrange the chairs into a circle and turn this into a Quaker Meeting and all these people who feel that they have something to contribute should speak, but I do not think we will do that.

It is very nice to see that even despite the weather that you have come here to talk about an issue which I think I have talked about on this podium at least a half a dozen times, and I am by far the youngest member of this panel. We are very lucky to have three people here who are distinguished by the fact that they have both worried about long-term and short-term budget issues both inside and outside government which I think is an important perspective. I am always frustrated when one goes into conversations with economists about the tax code, and they usually start with assume were designing the tax code from scratch, and then I always sort of tune out because as we all know, we are stuck with the tax code, and that is a little bit the way I look at the federal budget.

Jim Jaffe, who used to be a P.R. man for Dan Rostenkowski, talked me into going into the budget committee at Temple Sinai where we are both members, and he said, you will see, it is just like the federal budget. After about the third time, I realized that he was right. The budget committee at Temple Sinai begins its work each year by taking 95 percent of the stuff off the table as uncontrollable and then spends the rest of the budget season arguing over the remaining 5 percent. I am afraid that that is a little bit the character of federal budget policy discussions in Washington many times, but this is an exception. I think the plan that has been put on the table here is one that really takes what are the practical political and economic realities, takes nothing off the table and tries to move the big pieces and not argue about the little ones toward getting us to a more sustainable position.

Our speakers today and the signatories to this plan are former Congressman Charlie Stenholm from Texas who was for 26 years in the House and is now at Olsson, Frank and Weeda, Belle Sawhill who leads the Budgeting for National Priorities Project here and has been going all over the country on a fiscal wakeup tour who also did a stint in the Office of Management and Budget in the Clinton Administration, and Bill Hoagland who spent 31 years in the federal government, and it is very nice to see him exposing himself now in public no longer hiding behind those great insights that reporters in Washington have always taken on their own because they could not give him credit, he is one week into the private sector at Cigna Corporation where he is now the Vice President for Public Policy and will defend everything that every insurance company has ever done, and just give him your card if you have any claims issues to take care of.

Our order of business today is we are going to start with Congressman Stenholm, then Belle Sawhill, and then Bill. Each of them is going to talk for about 10 or 15 minutes, and there is a timekeeper here somewhere in the audience and I am the obnoxious reporter who will cut them off when they need to be, and then we will have some time for questions. Congressman Stenholm?

MR. STENHOLM: David, thank you very much. I am reminded often of the words of now Senator Pat Roberts when he said, if you are going to be a big flea, you got to run with tall dogs.

(Laughter)

MR. STENHOLM: This is the closest that I have come to being a big flea, being associated with this panel this morning and talking about a subject that has been bothersome and worrisome to me over the years, but I guess it comes from an agricultural background. Deficits have always mattered to me, and it has been amazing particularly in the last 6 years to see so many so-called conservatives suddenly say deficits really do not matter. That has been mind-boggling, but as my wife Cindy points out quite often, you have been saying that for a long time and it doesn't seem to matter.

I guess one aspect of that is that we have not paid a lot of attention as to who owns our debt. I remember in 1981 when I helped pass the $1 trillion debt ceiling limit, and we know $8.6 trillion back in 1981, foreign investors owed about 25 percent of our debt, today $8.6 trillion, foreign investors own about 50 percent. And at the rate we are accumulating debt through the deficits that we see now as far as the eye can see really with the current policy, foreign investors are going to own in excess of 60 percent of our debt in the next 5 years.

I guess that is the farmer in me that comes out and says I have always known my banker has something to say about how I function sooner or later. You cannot ignore your banker, and this is bothersome to me.

One of the things that I when I was asked to participate in this, what do you do about it, the key is everything has to be on the table. The moment you start in the budget debates and you take something off of the table, then you have immediately taken something else off, because if you cannot start with everything on the table, you are not going to get there.  One thing that I have appreciated about the 110th Congress thus far is they put pay-go back on.  That is a good step forward.  It works.  It causes you to have to make tough choices.

It has been amazing to me that those in the Senate and in the administration that oppose pay-go if it includes taxes, it seems to me that they are missing the key point.  If you want to cut taxes, cut spending.  Cut it before you cut the taxes, or cut it simultaneously with everything on the table.  We haven't seemed to be able to get there over the last several years, but it is going to be an interesting year this year.

Blue Dogs, they tell me once a Blue Dog, always a Blue Dog, so I am the senior retired dog in the kennel now, but there are going to be some players this year because, as you know, that is what Blue Dogs are all about, trying to get the fiscal policy back under control and they are kind of like the little dog that chased that bus every day, and he caught it now.  Being in the majority means that there are going to be some opportunities for leadership, and I think the Blue Dogs are certainly going to be up to it.

Another general principle of deficit reduction that I think is really going to be important and applicable this year, and some call it sunset legislation, some call it oversight.  To me, something that Texas started doing several years ago is reviewing every program in the Texas State Budget every 10 years.  Maybe it wouldn't be a bad idea to do the same thing with the federal government.  I know a little bit about agriculture and I know that there are a lot of programs that we've got there that should be reviewed, ought to be looked at, and one of the things about pay-go, it makes you make tough choices. If you want to continue Program X, you are going to have to find something to cut or have the guts to say I want to raise taxes to pay for it. And you show me anyone advocating new taxes, and I will show you somebody about to get unelected. So it makes it so that the tough choices are made.

The final point that I would make is on the so-called entitlements, Medicare and Medicaid. There are some great ideas now beginning to come out as to how we do get under control entitlements. I got involved in the Social Security reform about 12 years ago now. Jim Kolbe and I at CSIS, we put together a plan and I am still pushing it. There is an organization called For Our Grandchildren that I am working with, Tim Penny and I. I still believe that individual accounts have got a role to play in the future of Social Security. I believe that. I can sell my three grandsons on it, aged 11, 9, and 3-1/2. Every time I've asked them, they are for it.

(Laughter)

MR. STENHOLM: But it is interesting how many those of us 65 and over are opposed to it. I do not understand that. But here my point is this, if we are going to fix Social Security for the future, there are only really four things you can do, cut benefits, raise taxes, borrow the money, and way over here, provide individual accounts to provide an incentive for those in the upper-income to in fact participate, and to those in the lower-income, once they understand individual accounts will find that they have a better plan than current law. But we have never been able to get there because of the politicization of that issue. It just my party automatically takes it off the table if you've got individual accounts.

The other extreme takes taxes off the table, and that means to me if you are going to continue to have that argument on Social Security, nothing will get done. We and FOG, For Our Grandchildren, have been pounding the pavement both sides of the aisle, but mainly on our side now, pointing out that if you are going to fix something like Social Security, the best time to do it is when you've got a Democratic Congress and a Republican in the White House. It offers the best opportunity to look at the policy and make those changes that will in fact fix Social Security for our grandchildren.

The former optimism in the f-a-r-m-e-r comes out, the glass is always half full, so in spite of the negative comments and in spite of everything that is going on today, I believe the 110th Congress is going to step up to the plate in the next 6 or 7 months and is going to at least attempt to fix that one little component. Then we will go to Medicaid and Medicare, and that is a tougher nut to crack.

MR. WESSEL: We will come back in 6 to 8 months and you can explain to us how it all happened.

MR. STENHOLM: That's right.

MR. WESSEL: Belle?

MS. SAWHILL: I don't know what kind of dog I am, not a tall dog, maybe an old dog, and I wish I had a few new tricks in my satchel here for what to do about this problem. But we did attempt to put together a paper that lays out a plan for getting control over the budget over the next 5 years and then keeping it on a sustainable course thereafter. I was very pleased and honored to be joined not only by Mr. Stenholm and Bill Hoagland, but also Bill Frenzel who is up at cold, cold Dartmouth this morning and wishes he could be here. But I had a nice conversation with him just yesterday and he is very much behind this plan.

That doesn't mean that all of us support every element of the plan, but we understand that compromises are needed and so we thought maybe we could suggest one way you could get to where we need to be fiscally and that it both suggest some ideas and also be something of a model for what needs to happen in the real political world.

I am going to focus on what we do to get to balance over the next 5 years, but I want to really emphasize right up front something that Charlie just alluded to which is the entitlement programs that really need to be addressed over the longer-term. I like the way Ben Bernanke, the Chairman of the Fed puts it: he says this is just the calm before the storm; after all, deficits are not that large right now particularly as a share of the economy, and I suspect we will see some more good news in the short-term, but you go out a couple of decades and the storm comes. I think to deal with the storm we need to batten down the hatches now. We need to get ready for it and, therefore, the goal of making progress over the next 5 years is an important one.

We propose a plan for the next 5 years that is about half spending cuts and about half revenue increases. On the spending side, what we suggest is that maybe we should just freeze all annual appropriations, so-called discretionary spending, at current levels. That is very hard to do, Congress would balk at doing that, but if you think about it, it would force some tradeoffs and some reallocation. It would not mean that some programs could not be increased, it would just mean that others had to be decreased to keep the total flat at current levels. That, by the way, is just a little bit more restraint even than what the president is calling for in this year's budget.

MR. WESSEL: Belle, let me make sure, so you are talking a freeze on both defense and domestic?

MS. SAWHILL: That is correct.

MR. WESSEL: So if you increase defense spending, you would have to cut domestic spending?

MS. SAWHILL: Yes, but I should clarify for all the wonks in the audience, including you who are up here, that we use a defense baseline that is basically the administration's defense plan, it is not just a defense baseline that is adjusted for inflation. We have a whole paper on where you could cut the defense budget. The author of it is sitting here in the front row, and I think it is a great paper. Please raise your hand, this is Jeff Tebbs. And for any of you who are interested in the military side of the budget, he has worked very hard on this. We have a set of Fellows here at Brookings who represent each of the branches of the military and he has interacted with them and other experts here like Mike O'Hanlon on these issues.

We have laid out in a series of papers, not only this paper on defense, but other papers and books here at Brookings, some specific areas that you could cut both on the defense and the nondefense side, so we think this is very doable. But if Congress cannot agree on what to cut and what to increase, then the default would be a freeze, a so-called hard freeze.

What about the revenue side, the other half of the package? Here we do four things. First of all, we broaden the tax base, and we do that primarily by turning the current exclusions and deductions into a 15-percent credit for everyone. So if you have a mortgage interest deduction, right now regardless of the cost of your house, it is worth more to you if you are in a high tax bracket than if you are in a low tax bracket, so this would level the playing field so that everyone gets the same credit.

We also cap the exclusion for employer-provided health care. That is very similar to what the president or the administration is proposing right now, and I think there is a fair amount of agreement at least within the expert community that that would be a good thing to do because it would help to prevent the further excess demand for health care that comes from people having very generous third-party payment, third-party insurance to cover particularly first dollar care.

People of course will say immediately how can you cut back on something like the mortgage interest deduction? Isn't that politically impossible? Of course, it is very, very difficult, but bear in mind that if I said to you we are going to provide subsidies through the spending side of the budget to allow relatively affluent people to have subsidies on the purchase of a home, would that be a good use of everybody else's tax dollars? But that in effect is what many of these deductions do.

The second thing we do on the revenue side is we place a tax or a fee on carbon emissions. This is designed to deal with global warming and energy security. There was a nice op-ed in yesterday's Washington Post about why we need to do this and, again, people have said for many years that is not politically feasible, but just in the last few months some of the major CEOs of our major companies including General Electric, for example, have come out in favor of something like this.

We do assume some modest savings from closing the so-called tax gap, the difference between what people owe in taxes and what is being collected. We are a little skeptical that the savings from that can be very large, but we do call for that and get some revenues in that way.

Finally, we reformed the so-called the alternative minimum tax so that it does not engulf more middle and upper-middle income tax payers, and we pay for that fix by retaining the estate tax but with a very high exemption level of $7 million per couple. Notice we do not raise anyone's tax rates. In fact, we generate more revenue by just broadening the base and not by raising rates.

So if you add up all of our spending cuts and all of our revenue increases, you get what we call a fiscal responsibility dividend. That is the savings in interest costs from bringing the debt down over 5 years, and that is a little more than $50 billion. We say as a reward for doing that, and assuming it has been certified that it has been done, we say let's reinvest that in some high-priority initiatives. Everybody will have a different idea of what their favorite initiative might be. My favorite is early childhood education. Yesterday I had the opportunity to comment on another speech by Fed Chairman Bernanke in which he called for the same thing as a way to improve social mobility or opportunity in the United States, and that is where I am as well.

Let me sum up then and turn this over to Bill to talk more about the longer-term and about entitlements. I think this 5-year package is not just an eat-your-spinach package. It does leave room for some new spending initiative which after all can strengthen the nation as much as reducing the deficit. The whole economic rationale for reducing the deficit is not to reduce national savings and crowd out private investment, but you cannot grow an economy with private investment alone, you need educated workers, so they work together hand in hand, so we should not get so intent on focusing on the deficit that we never do anything else.

We do address global warming and energy security, we do begin to reform the health care system in a positive way, so I think this package has some merit, as difficult as it is to get from where we are now. Let me stop there and turn this over to Bill.

MR. HOAGLAND: It is entirely appropriate that I go last up here because I was one of the last ones to come to this project and probably contributed the least amount to the project, but that is in large part to what David said, that I just a week ago today completed 31 years of government service and of course I was not entirely free to express my views and opinions then.

The last 25 years have been spent in the United States Senate as a staff person. I respect that institution, but I never got a law named after me in all those 25 years, so now that I am free, I am going to make up what I call Hoagland's Law. Hoagland's Law says that the level of effort expended by a Congress on budget reform and budget control is inversely proportional to the benefits provided at the federal fisc. Let me give you an example, earmark reform. I am not opposed to controlling unauthorized spending or tax provisions for no other reason than to increase efficiency and effectiveness in government, but from my vantage point, earmark reform compares nowhere near to that of the challenges it faces with entitlements we have discussed here.

Let me also get off my chest right up front here the word entitlement. Certainly, our Founding Fathers made clear in their writings that we had certain rights, but you are not going to find any place in those wonderful documents that we are "entitled" to a specific government benefit. Over time I am afraid we Americans, and particularly my generation, have come to expect that government will be there to provide us with our every need. Some of us will even go so far as to vote and support those members of Congress who increase my entitlement and pass the burden off to our children.

On the big-three entitlements, Medicare, Social Security, and Medicaid, they are all important public programs and they are indelibly marked on our social contract, no question about it, and the objectives of providing retirement and health security for millions of Americans who would be in poverty if it were not for these programs, that is going to continue. But for others, when dependence on those particular programs sacrifices personal family responsibility or personal responsibility or personal savings because we are entitled, then I think we are endangering not only our economy, but particularly our political system.

What I am trying to suggest here is changing a law is one thing, but I think we also have to change attitudes in this country about what it means to be entitled. Taming the deficit to pay for what are putting out focuses on the three big ones. As Belle indicated, we are trying to get the balance by 2013, and literally in the 2013 in the outline of the package, we only have about $40 billion in entitlement savings in that year, when the total amount of savings in that year is close to $400 billion for both spending and taxes. So only about 10 percent of it comes in that last year, and that is for simple, good policy as well as good politics. The changes to these programs will be incremental and the savings will increase over time, as it is easier both politically and programmatically to prevent an automatic increase than it is to reduce an already provided benefit.

In total, entitlement spending by 2013 and all throughout the entire federal budget was we estimated somewhere around I guess 60 percent of all spending by the year 2013, and if you throw in the most uncontrollable of uncontrollables, net interest on the public debt, two-thirds of the budget then by that year falls into this category of entitlements. But we focused on just the big three which represent in that year about 51 percent of all our spending and those whose continued growth beyond 2013 represent the real challenge to sustaining fiscal sanity in the years beyond. This audience is well aware of the reasons why that is the case. The nature of this business that we deal with is to make estimates about the future, and because they are estimates, they will be wrong. So why should you or why should congressmen up for election next year of 33 Senators or those running for the higher office of the presidency believe any numbers either near-term or 5, or 15, or 20 years out in the future? As I like to say for one reason, I am certain of one thing in my projections, and that is that everyone in this room will be 10 years older 10 years from today. That is a certainty, and that is the problem. Peter Drucker used to say that demography is the future that has already happened.

I used to talk about the long-term challenges that confronted the country when I first started to work with Dr. Rivlin up here at the Congressional Budget Office. The first paper I think we worked on was the year 2000. I thought that was so far out into the future that that is never going to come to pass. But what we are faced with is that, of course, as many of you know, it is not way out in the future now, it is not 5 or 10 years, it is next year when the first of us baby-boomers, 75 million of us born between 1946 and 1964 can begin to qualify for reduced Social Security benefits. The next election and those to follow for some time will be taking place with the background of these boomers rolling onto the benefit rolls. The Bill Clintons, the Bill Gates, the Bill Frists, the Bill Hoaglands, the George Bushes, were just the tip of the iceberg, and if left unchanged, these entitlements, and revenues remain at historic levels, it creates the nightmare scenario that has been outlined by such divergent groups as Brookings and Heritage in their fiscal wake-up tour.

So what does it propose to do with entitlements? On Social Security, it is probably too late to do anything about those who are near retirement. In fact, we should have done this 10 to 15 years ago, but presidents and congresses have already locked us in to the fact that we cannot change those who are near retirement. That leaves us a few options, at least in this particular paper we outline three. One, we speed up the age of retirement to reflect the fact that are living longer. The full age of retirement under current law is in the year 2017 when you could retire at 67, we would move that up 5 years and so that we would get there by 2012. We change the benefit formula to a new COLA adjustment that is again short-term. Also a significant change that could make a big difference here is simply changing the initial benefit calculation from benefit-to-inflation adjustment as opposed to real wage. Then to pay for, as Belle mentioned in terms of on the tax side, we would cap the payroll taxes at $97,500, but we also modify the formula that it remains somewhat progressive those in that range. That creates you about $10 billion in that year, $26 billion over the 5 years, primarily from the COLA adjustment.

However, when we talk about entitlements, it rolls off the tongue so sweetly, the real issue comes down to health care to my mind. It would appear that we are beginning that debate again on health care, how to slow the growth of health care costs while at the same time expand benefits to the uninsured. As that debate unfolds, however, this paper takes the position that we still need incremental changes to start to lay the groundwork for the future, so we expand means testing for Part B premium which is just now going into effect from law changes that were made in 2003, and that saves, all our Medicare savings in this package, and I hope you are listening, is $112 billion over the next 5 years. Those of you who have looked at the president's budget this week will know that he is a piker compared to what is in this paper, where I think the president's proposals are close to $70 billion. But we are at $112 billion, and the big one comes from this Part B premium. When that was put into existence, it was supposed to cover 50 percent of the cost of the premium for the individual, which is now down to 25 percent with some little means testing which attacks about 4 percent of the Medicare recipients. So this plan envisions that we would actually move the subsidy, if you like, from 75 percent to 65 percent, in other words, that 25 percent subsidy up to 35, and we would return about a third of that back to the low-income people.

On the broader health care proposals now being tested I think in the various states, maybe some of us will bring us some benefit there, but I just have to point out that at the federal level, the goal of universal coverage is that I think the difficult is we are going to see that this is going to conflict with the overall objective of reducing cost in the long-run, and so how do you expand coverage, reduce it, and this paper also includes a rather controversial proposal of putting a VAT in place of 2, to 3, to 4 percent to provide coverage for the uninsured.  Short of comprehensive centralized health care delivery which I guess I believe would end up rationing and fixing prices, I do not know any of the options before that are pleasant.  We are going to have to reduce reimbursement rates for hospitals, doctors, and other health care providers, and we are going to have to shift more of that cost on to the individual.

There is one area of promise which I would like to highlight that we mention in the paper, and that is that it is estimated that about 30 percent of the increase in mandatory spending for Medicare and Medicaid over the next decade will come not from caseload growth of that population and not from increasing benefits, but from simply increasing per capita doctor's visits and costly medical technology.  So if there is a way in which using health information technology, health benefits, and protecting the privacy of the individuals, there are efforts underway, there is a little bit of money in the president's budget, that would allow you to match this up to reduce some of the high-cost technology and make it more efficient, and increase the quality of care that would be another area of real effort as we go forward trying to control the cost of health care.

In the short-run, however, once again, that is cost versus benefits promised in the future, and possibly that would be another area for Belle's fiscal policy dividend to use to take care of this.  But for rising health care costs, I guess not only for the federal, state, and public, but also for individuals and for private businesses, I think the question is it eventually comes down to how much the country is willing to devote to this sector of the economy, and depending on the answer to that question and unless we are willing to pay for that level of care, what is it that we are willing to give up.  I do not think there are any simple answers, if there were, there would not be a need for the paper that we presented here today.

MR. WESSEL:  Thank you all.  Let me start with a couple of questions, and then people in the audience should be thinking of theirs.

The president has been through an extraordinary 6 years where he has been able to cut taxes, increase Medicare benefits, fight a big war, and increase discretionary spending without obvious strains on the economy.  I think we all know that that is remarkable and has a lot to do with the willingness of foreigners to keep lending us money at attractive interest rates.  But now he puts on the table a budget which by his reckoning gets us to balance a year ahead of you, does not require any tax increases, and actually allows his tax cuts to continue.  Why do we need all that you are saying given that we have had 6 years of deficits with no strains, and what is wrong with his proposal to get us there with so much less pain?

MR. STENHOLM: He doesn't have the votes.

MR. WESSEL: Why wouldn't he have the votes? I would vote for his choices, which means more tax cuts and fewer spending cuts than I would vote for yours, and he gets to zero. What is wrong with his plan on the numbers?

MS. SAWHILL: I do not know the full answer to that, and it is a good question. I have tried to think about it. There are a few things that he does that make it easier for him to get there. One is he fixes the AMT for only 1 year; we fix it for 5 years. That is an expensive fix. The political probability that middle-class and upper middle-class tax payers are going to sit still while being pushed into these higher tax brackets which is basically a stealth tax increase, is improbable, so that is one reason why they get to balance and an easier way than we do.

There are real questions I think about the defense budget. There are questions about the economic assumptions. If you have a strongly growing economy, it is going to throw up a lot of revenue. There is the issue of then how you think the revenue yield is related to the income projection. So there are a lot of questions in these projections.

I think that the administration had a somewhat more transparent process this year than in some past years, but I still think they are being pretty optimistic and leaving some stuff out.

MR. HOAGLAND: I would be happy for either one of the packages to be adopted because I think none of them will be right, none of them will have the right number in the year 2013. I think Belle has an important thought as it relates to defense. As I recall, we do assume that that is a continuation in the baseline and they have come down rather quickly as I recall and do not have anything in there. Their discretionary number in terms of a freeze is basically where we are until you get back down to the entitlements. And as I say, he is a piker compared to where we are, but where we are looking at I think is beyond 2013, and some of this is sustainable in terms of what we are talking about going beyond 2013 that he is not looking at. I would be happy with his package, but I agree with Congressman Stenholm, his package will not pass because everything is not on the table.

MR. WESSEL: That raises a second question about the politics of where we are right now. If we had been having this conversation a year ago, some things would have been different. One is that the Democrats now control Congress, and I am interested in whether you think a divided government situation is more likely to produce some sort of action on the budget than when one party controls both the Congress and the presidency. The second thing that has changed is that the administration has not just changed its defense team, it has changed its economic team, and I am interested in what your reaction is to the combination of Josh Bolten as Chief of Staff, Rob Portman as Budget Director, and Hank Paulson as Treasury Secretary and whether that changes the dynamics at all. So there are two questions, really. Does anybody want to take a grab at it?

MS. SAWHILL: I think that the three people you have just mentioned on the team are all terrific people and could make a difference. So I will be somewhat optimistic about that.

One of the problems is that there are two messages coming out of the administration right now. There is one message coming from the Treasury

Secretary and the Budget Director saying no preconditions, it is close to Charlie's everything on the table, but the President and the Vice President do not seem to be backing that up, they seem to be saying something a little differently, particularly the Vice President.

On divided government, I received an interesting Email from Alice Rivlin yesterday who is sitting right here, and let me use this as an excuse to bring her into the conversation since she has been head of both the Congressional Budget Office and OMB, as most of you know, and she is writing a book for Brookings right now or editing a book with Joe Antos at AEI on health care and the budget and she and I have done a lot of work together on this. Alice, do you want to talk a little bit about the divided government issue? Is it a positive thing to have divided as opposed to unitary?

MS. RIVLIN: I think it is a positive for those of us who care about fiscal responsibility. I was going to come back when I got a chance to ask a question to Charlie Stenholm's statement that this is the moment to fix Social Security, and I think it is. We have a president who put a Social Security plan on the table and who needs a legacy desperately, we have a Democratic majority in the Congress that would I think, I hope, like to prove that Democrats can get something done, and the moment for fixing Social Security I think is really here, provided that the sort of extremists in both parties can get together.

I want to ask Charlie, I agree with you that personal accounts which seem to be very important to the Republicans could be part of a very long-run solution. The thing that is going for personal accounts, I think, is not so much the personal thing, but the fact that it would reduce the ability of the Congress to spend a Social Security surplus. But they are very expensive. We have to figure out if you are going to allocate any of the current revenues to Social Security personal accounts; you will have to make up the difference somehow. They are not a solution in the next several decades to the any fiscal responsibility problem.

So I do not know what your view is, Charlie, of how you get this together, but do you see a way, you and your fellow grandparents, to get some limited nod in the direction of personal accounts that will be acceptable to both sides of the aisle?

MR. STENHOLM: That is one of those 30-minute questions that I will try to give you the 1-minute answer to.

MR. WESSEL: Can you get a dog and a flea into it?

MR. STENHOLM: Yes. The theory behind the plan that Jim Kolbe and I and now somebody else is going to take is that you take those fortunate to make more money and you cut their guaranteed benefits to provide for the up front, reduce it as much as you can, and we have put together a plan that did a pretty good of that. But you are right, it does take some costs up front, but nowhere close to what some of those who advocate privatization and just totally taking it out.

You have to make some cuts in guaranteed benefits. The theory is that the upper income and, again, grandchildren, you tell a young person today just entering the workforce that we are going to reduce your guaranteed benefit by X but we are going to give you an individual account to allow you to invest like in the thrift savings plan type of an account, most young people will say why just give us 3 percent, give us all of it. And then you explain that you have to take care of those that are on and soon to be on it, et cetera, but you can do it. It can be done if you are willing to make enough cuts in the guaranteed benefit and then the tradeoff that comes.

The first time around we suggested that you increase the age at which you can draw your Social Security to 70. Then my senior Senator Phil Gramm campaigned 3 days in my district to get me beat that year for the audacity to suggest that we are going to increase the retirement age. Come on, folks, if we cannot do that for our grandchildren and get more realistic, you are going to have a heck of a time getting it where we need to go.

You will have to make some tough calls, though, and that is why I will emphasize again that the best time to do it is when you have a Democratic Congress with everything on the table and a Republican president working at the table, and on Social Security, one of the biggest disappointments, the views you are hearing from me contribute to me being here as a former member, because Mr. DeLay and Mr. Rove took after me from the word go because of the views we had regarding the budget, and they got me. They redrew my lines and got me. Politics is a contact sport. They got me, but I think they are wrong.

MR. WESSEL: The last time I checked, Mr. DeLay did not exactly land happily, though.

MR. STENHOLM: Well, there is justice.

MR. WESSEL: Bill?

MR. HOAGLAND: Back to your two questions, first of all, I think that the powerful paid of Paulson and Portman are having a big impact. At least this year deficits matter, which up until this point I have not heard that, so I think that is important.

Divided government. The last time, 1997, 10 years ago, we are celebrating the tenth year anniversary of the Omnibus Budget Reconciliation Act of 1997 when we actually did something, and while I do not know whether it was because of that, it certainly had a big impact.

However, maybe it is just my cynicism of having left up there recently, I have to say even though it is divided, it is more divided than normally divided, and I have to say the types of issues we are talking about here particularly as it relates to Social Security, as much as I would like to agree with you, I think that people feel their hands were burnt. We are moving into a 2008 congressional and presidential election that has already started, and I do not see with the powerful lobbying groups in this town that you are going to be able to get that on the table unless the president is willing to do something that is in this paper which is take the cap off of the $97,000, and I do not think he is going to do that.

Second of all, as much as I would like to say that there is a bipartisan agreement to work out here, as much as a powerful pair as Paulson and Portman, as long as the president is going to continue to propose the extension of the tax cuts, I do not think you are going to get any movement on Capitol Hill and I think all this is going down to 2008, and I am sorry to hear that.

MR. WESSEL: We won't be overly optimistic.

MS. SAWHILL: I really want to emphasize the last point. I think that Democrats right now are very much hampered by the fact that they cannot do anything about the tax cuts and the extension of them because anything they did the president would simply veto. Even if they could get it in a budget reconciliation and do it by majority vote that way, it would still be vetoed. And I think that Social Security is so important to them that they are not going to give that up unless they get something big in return, and the big thing in return they would have to get would be some compromise on the tax cuts. Even though in our paper we do not talk about raising rates or not doing the extension, nevertheless, people need to understand that those tax cuts have been extremely expensive, that extending them is going to cost $1.6 trillion over the next decade, and so although they would not solve the growing cost of entitlements over the longer-run, they would help a whole lot if we changed them in some way.

MR. WESSEL: In your baseline here, do the tax cuts disappear or are they extended?

MS. SAWHILL: We extend them for the same reason that many people do, that it is a more realistic baseline right now.

MR. STENHOLM: I would add on as to Paulson and Rob Portman, I agree with Bill that they have got a trust factor; it is the problem of dealing all over. On the House side it is dealing with the lack of trust or the trust deficit in the administration, it is real and it is not going to go away.

But one of the things that did not make our paper as far as Bill talking about his pessimism in the Senate, one of the things I suggested in our paper that did not make the cut is I thought we ought to cut out the Senate.

(Laughter)

MS. SAWHILL: On another light note on your first question about the new team in the White House, I don't know how many people know that Josh Bolten has a jazz band and that it is called Deficit Attention Disorder.

MR. WESSEL: I am prepared to keep asking questions, but I don't want to. There is one hand. Thank you. Why don't you identify yourself for us?

MS. BLAXALL: Yes, Martha Blaxall, Brookings. I am just wondering about the optics of all this. Steve Rattner had an article in the op-ed section of The Times yesterday in which he said if we would get some of the numbers on the accrual accounting end of this thing out in the public, maybe we could get more support for doing something about it. Nobody ever talks, except Brookings, perhaps, in the Fiscal Wakeup Tour, about the longer-term liabilities associated with Social Security, Medicare, and so forth over the next several decades. Why is it that no one in the government seems to put out those numbers and deal with them? Is there a reason why nobody wants to talk about the long-term liabilities?

MS. SAWHILL: Could I use that as an excuse to bring in some other people who are here who have been working us as part of the Fiscal Wakeup Tour from GAO? Because the person who has been most articulate and most passionate about this set of issues has been Dave Walker, the Controller General of the United States, and he does participate in the Fiscal Wakeup Tour. By the way, the Fiscal Wakeup Tour has now been to 16 cities. We were in Iowa last week; we are going to New Hampshire next week. We are basically trying to get the public educated about these issues in a way that will make it more difficult for the candidates who are coming through the primary states to duck this question of what should be done about the fiscal situation going out into the future.

Sue Irving or someone, do you want to say anything more about this accrual accounting issue? Introduce yourself.

MS. IRVING: I am Susan Irving and I do the backup for the Fiscal Wakeup Tour for Dave Walker. I also run some other work on the federal budget, but Jay McTigue who does all our numbers is here also.

Actually, one of the things that I think a lot of people do not know is that the federal government does do accrual accounting. Our financial statements are done on an accrual basis as governed by the Federal Accounting Standards Advisory Board. We budget on a cash and obligations basis. I will give you that there is a very good reason not to go entirely to accrual budgeting. We do do credit on an accrual basis in the budget. We think you should do insurance. For a lot of the budget it would be a 2-week difference, my salary. For capital it would be less control because you would pretend you only bought a thirtieth of a building when you actually committed the government to buying the whole thing.

And I would argue, and OMB, GAO, and Treasury would agree or take this position, that Social Security and Medicare, although implicit exposure to the federal government, certainly expected commitments, are not technically liabilities under the accounting standard and should not be, and for a lot of reasons you do not want to divert today to talking about. We do try to increase an understanding of what the long-term implications are, and Dave does use on the Wakeup Tour an estimate for major fiscal exposures, because if you imagine that you wanted this generation to lock away enough money to pay those off, what would it take? It would be something like $50 trillion which you then convert for every man, woman, and child in America to make you understand it, to make it mean something, because David is very articulate to point out a trillion, what's a trillion, what's a billion, what's an elephant?

MS. SAWHILL: That's $156,000 for every baby being born?

MS. IRVING: For every man, woman, and child. The other thing to say is the Rattner column I think reflects that he has been away a long time, that he decided to take a shortcut in applying financial accounting to a budget and to think that cash-flow in the federal government is the same as in a business, it matters when we have to do the borrowing, and I would refer you to some columns by other people including the moderator for a more sophisticated analysis. David knows me well enough to know --

MR. WESSEL: I want to say that if what you say about the difference between me and Steve Rattner is right, then I have some questions about how the market sets our relative wages.

Let me respond to that, because I have a different view on this. The first thing I would say is I am not convinced that Americans respond to numbers in such a way that would really change the discourse, and if I could think of a way to have a conversation with the American public, and I imagine a conversation practiced by somebody like Bill Clinton or Ronald Reagan to explain to people the kinds of issues that are discussed here today, it would be much like Charlie Stenholm is talking about grandparents and it would come up with some interesting metaphors that are not quite accurate about who if you do not save for your retirement you are dependent on your kids and so forth, and it would have very few numbers in it because I do not think that moves people. So I would not waste a lot of time if I were fighting this battle worrying about exactly getting the accounting right, I would worry about getting the politics right and a way to go beyond the numbers.

The second thing is one problem here is, and Susan was referring to this, the fault of our language. The difference between million, billion, and trillion, when you hear them, it just does not seem all that different. I think it was Dave Barry or somebody who once pointed out that if we had only called them grapes, grapefruits, and watermelon, that the contrast would be so clear to people that people might respond to these numbers.

MS. SAWHILL: If I could add one thing about your point on analogies, it seems to be better than using an analogy to business is to say a lot of parents lend their kid one of their credit cards when they are growing up. This is the other way around. We are using a credit card which our children will pay the bill on.

MR. WESSEL: Exactly.

MR. STENHOLM: I agree totally, David, with what you just said, and as one that has been a budget wonk and made more town hall speeches and talked more about this, you are totally right. We have got to change that and get back to some simple policy changes.

MR. MOHOROVIC: My name is Joe Mohorovic. Given the nature of the paper "Taming the Deficit," I was really surprised by the decision from the authors to devote two-thirds of the fiscal dividend in new spending and only one-third in deficit reduction. Was that a decision that was controversial among the authors? I am surprised that not a greater percentage was spent on deficit reduction as opposed to new spending alternatives.

MR. STENHOLM: I will say it from my perspective that when you take a look at what we are suggesting on discretionary spending, that is going to be a pretty tough hill to climb in the real Congress, House and/or Senate. The things that we have made mistakes in the past on are we set the numbers unrealistically politically, and then we don't make them, you fudge them. But if you set a realistic number and you give some flexibility in this, you've got a better chance of achieving your goal. That is my thought on it why I didn't suggest otherwise.

MS. SAWHILL: It was a subjective judgment. We took the money that we needed to get to the goal and we did want to have something in the package that was significant enough to be able to argue, which I personally feel strongly about, and I will let these two speak for themselves, that deficit reduction is only a means to an end. It is a means to making the country stronger, and it is not the only way that you make the country stronger.

As I said before, investments in education I think they have to be wise investments, they have to be effective investments, but they can be just as important to our future as getting our fiscal house in order, and there are other things. Bill Hoagland mentioned investing up front some money in things like electronic medical records or doing more research so we get a handle on what treatments are effective and which are not. There are a lot of things that we need to do in this country that we are not doing right now and this is because of the fiscal shape we are in, and so I think a balanced package has to leave some room that makes selected wise investments in the future.

MR. STENHOLM: If you are going to make the argument as some do that deficits really as a percent of GDP are not that big a problem, and I don't have any problem buying that, but if you are going to make that argument, then you have got to use the same rationale on discretionary spending. We the Congress over the last 10 years have done a pretty darn good job of cutting discretionary spending as a percent of GDP. So if you are going to argue one side, you got to be consistent on the other side.

MR. WESSEL: Wait a minute; this is a whole new principle, consistency. Don't set your standards so high. Is there another question? Let me ask one, and then I think we should end this. When you guys sat down, I think you probably did not have much argument about what your goal was, right? I think you were pretty clear on the goal. But you chose to try and do a consensus thing, and Belle made a big point about not everybody agrees on what you came out with. I wonder if you could each talk about something where if you were in the room and you were making this thing, if the president decided and Congress decided that this is never going to work democratically and we are going to appoint a Federal Reserve Board-like agency to make some up or down recommendation like the base-closing thing, where is it that you think you would have the hardest time making the choices? Where is it that the issues are the most delicately balanced and you are a little bit ambivalent on? Do you want to take a stab at that, Belle?

MS. SAWHILL: I think that I would like to hear from others on that because it was my thinking that you want to as much as possible have proposals that will accomplish something other than just deficit reduction. That is why I like the energy tax, for example, because it not only gets you to new revenue, but it does much more than that. It deals with the environment, it deals with our dependence on imported oil, and it addresses what I think is an increasing public concern about energy, security, and the environment.

Similarly, on the base broadeners, I do not see any reason why we should be spending so much money through what are called tax expenditures that may be on the revenue side of the budget, but really are not very different from spending programs. If you think about investing in housing, that is not good for the economy. There may be an argument that as a society that we care about having people be homeowners and we want to make it cheap for them and we want to subsidize it, but if you think about it, the more of our savings that goes into the housing market, the less there is for other kinds of investment. So it is not necessarily an efficient or a pro-growth policy to be spending as much money as we are on providing subsidies to people who are buying relatively expenses houses and who have very good incomes.

It is fairer, it is more pro-growth, you are not only raising revenues, but you are accomplishing some other objectives. This administration and their Republican allies have made a very big argument which I think has now become almost automatic in the public debate that if you raise taxes that it is going to slow growth. We are trying to point out in some of our proposals that you can raise taxes and have it be pro-growth, not anti-growth, and pro-efficiency. It is also fairer.

It is very interesting that the Fed chairman yesterday gave a speech in Omaha which I hope some of you have seen which talks a great deal about growing income inequality in this country. I do not think any of us believe that growing income inequality has been driven by government policy. On the other hand, the tax measures we have had in recent years have exacerbated the problem very clearly. So our tax proposals move not only toward being more pro-growth, more pro-environment, et cetera, but they also move toward a fairer system.

I do not want to talk too long here, but my principle when I was thinking about this was to try proposals that don't just raise revenue, but accomplish other public policy objectives as well.

MR. WESSEL: Bill?

MR. HOAGLAND: There were two issues that Belle and Congressman Stenholm know that I had some concerns about. One of them was just discussed, and that is the hard freeze on discretionary spending for the next 5 years. The one area of the budget that has already been mentioned where this administration and Congress either by default or by plan has really squeezed nondefense, nonsecurity spending. That is okay, but the way our plan is established as Belle knows is you do not get that fiscal dividend just put back into it until you get there, so it is a little stretch here, and this is putting my budget committee and Senate staffer hat on, I have got to go to the appropriation committees and tell them you will have to live with this with the promise that these other guys over here are actually going to reduce spending in health care and do the freezes and things of that nature, and maybe after 4 years then we will give you fiscal dividend. That one concerns me in terms of the design of the way we put it together.

The second one is I am not going to disagree with Congressman Stenholm about the pay-go and some of the things that later in the paper about process reform, but I think we have to keep reminding people of pay-go, it sounds to simple. Pay-go does not reduce the deficit. Pay-go simply keeps things as they are and balances out. So I am all for the discipline of it, but if you sell it like earmarks and pay-go and that is going to be our solution, forget it, pay-go does not do that. Pay-go simply keeps a level playing field.

MR. WESSEL: Congressman?

MR. STENHOLM: I represent the oil patch. I have done it for 26 years and I am still very interested in providing not only all the alternative energy we can but making sure that we do not decrease the amount of oil and gas produced in the United States because that creates an economic problem for us. You will have to have everything on the table. The carbon tax is something that needs to be looked at. Does this give folks that I am working with in my old district a little concern? You bet. It gives a lot.

This whole idea of energy independence is pretty tough if not impossible for us to get to, folks, particularly when we have the attitude that we are going to exclude some alternative energy. There are too many folks who are concerned about the environment but also believe that nuclear power should not be built. That dog won't hunt, but there a lot of folks who believe just as sincerely that it will as I do that it will not. So, all alternative energy. If you want more of something, you subsidize it. If you want less of something, you tax it. So as we look at this complicated energy policy, we have to keep those simplistics in mind.

But that means you have to talk about things that even folks will get uncomfortable, but if by getting uncomfortable you end up saying we can live with this provided you do X, Y, and Z, you have everything on the table, you ultimately get the kind of an energy policy that we need, and that is what I saw in this, that the carbon tax is something that needs to be talked about.

MR. WESSEL: Thank you. My kids are 17 and 20. When they were little I said to somebody who was involved in financial planning and college things that I could not figure out how we could possibly save enough money to send them to college. He said that he thought that that was one of the biggest problems that parents of young kids have, that they started out thinking it was impossible so that they never did it. He advised do not think you are going to save money to pay 4 years of a private college, just say you are going to save a quarter of it and then you will be surprised that you have some money at the end. I think that that is true and I have been able to pay the college bills, although that is another panel and we can talk about that.

But I think a lot about, is there some value in these exercises? We all have other things we could be doing this morning, and I think the most important value in the exercise is really not any one specific plank of a plan like this, but it helps enrich the public discussion to say that well-meaning, smart people who care about America and who are not trying to run for office can say there is a way to get to a more sustainable fiscal policy, and here is a way to do it.

And if that spreads, the notion that it is not impossible, it can be done, then that alone is a big contribution.

MR. STENHOLM: If we have this many policy wonks in an audience, I want to throw out a thought and an idea on the entitlements on the health care. There is a process now that is being used and we have used it in agriculture and crop insurance called data mining. By focusing on anomalies in the crop insurance, we have saved the taxpayer in excess of $460 million in a couple of billion dollar program per year.

When you look at Medicare, receipts per Medicare enrollee, there is a question that I have been asking, why does Iowa get $3,050 per Medicare enrollee, and Texas gets $6,350? We are not the highest, but we are up there, I can pick on Texas because I think it is a good question. One thing about data mining, you do not come to a conclusion, it is tort reform, malpractice and all of this. What you say is put all the information out, pick Iowa, Texas, and four or five other states and just look at see what is the difference. I do not think Iowans have 50-percent less health care than Texans, and I do not think we have 100-percent better health care than Iowa, but we are spending in the entitlement program twice as much in some states as we are in others. So that is something that when you start looking at how do you reduce the cost, you have to go through it and find out what is it that is causing some of this that is already not out there blinking, but there may be some little anomalies.

MS. SAWHILL: May I just add to that since it has come up? The research that has been done particularly by the people at the Dartmouth Medical School that shows this tremendous variation in expenditures across cities and states in the United States for Medicare, that even on a risk-adjusted basis, what Charlie has just said is exactly right. Some areas are spending much more than others and they are not getting better health outcomes. We know that. Bob Reischauer has done a calculation or cited one that shows that if we could get the spending in the high states or the high communities down to where the low ones are, it would save 20 percent of total Medicare costs. I do not think we can do that, but I just want to reinforce what you are talking about.

MR. STENHOLM: I was throwing that in to reinforce what you said a moment ago. We have to quit talking about numbers and start focusing on something that will gain the attention. David Walker is doing a beautiful job in the Fiscal Wakeup Tour, but if we could do this, and I think there is a good chance that it is going to get done, then we have some flashing things that can be saying here is what is happening and cause people to look at the practical side, and not the numbers and wonk side.

MR. WESSEL: Thank you very much.

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