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A DISCUSSION WITH PETER ORSZAG, DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET

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P R O C E E D I N G S

MR. GALE: Good morning, everyone, and welcome. My name is Bill Gale. I'm a co-director of the Tax Policy Center here and a senior fellow here at the Brookings Institution. Strobe Talbott is out of town on vacation, so I have the great honor of welcoming our speaker today, Peter Orszag.

Peter is well known to many of you, but I want to say a few words anyway. Peter served as the head of the Office of Management and Budget since the beginning of the Obama Administration. He's been an instrumental part of the economic team. He's had a leading role in putting together the administration's signature policies, including the stimulus package and the health reform effort. And, of course, he's been on the front lines of dealing with the fiscal issues facing the nation, which, of course, are also related to the economy, in particular, health care.

As the head of the Office of Management and Budget, he's also taken the M part very serious, the management part. In that regard, he's made major headway on a number of issues, in particular with the information technology gap in government. Before joining the White House, he served as the head of the Congressional Budget Office in 2007 and 2008. And before that, in what seems like a long time ago now, Peter spent six years here as a senior fellow.

During that time, he wore many hats. He was the Joseph A. Pechman Fellow, a title that I had before him, and I jokingly accuse him of stealing from me. He founded The Hamilton Project with the support of Bob Rubin and Roger Altman. He founded the Retirement Security Project with the support of the Pew Charitable Trust.

With Len Burman and Gene Steuerle of the Urban Institute, and me here, he served as co-director of the Tax Policy Center. When I became VP and the head of Economic Studies, I was lucky enough to entice Peter to be the deputy director of Economic Studies. I think it's only a coincidence that he left four months later.

And while he was here, he also wrote a book with Peter Diamond on Social Security, which remains, seven to eight years later, the leading reality-based book on Social Security reform. During his time here, Peter and I co-authored more than 50 papers and articles on taxes, retirement security, fiscal policy, et cetera. I've never had a co-author who is more fun to work with, who worked harder, or who could type faster on his handheld.

For the record, Peter is one of four Brookings scholars who has headed the CBO. Alice Rivlin was the first, later followed by Bob Reischauer, and now the current head, Doug Elmendorf. He's the second scholar from here to serve as the head of OMB, with the other one, of course, being Alice. In fact, he and Alice are the only two people who have headed both CBO and OMB, which is sort of a hat trick in policy circles and gives some indication of the wide respect that both of them hold in both the economic and the policy world.

Before his time here, Peter worked in the Clinton Administration. He held several spots in the White House at the National Economic Council and the Council of Economic Advisors.

Now, with OMB's mid-session review just issued last week, Peter is going to talk about the economic and fiscal accomplishments over the last couple of years and the road ahead as the nation faces the serious issues that we all know about. He'll then take questions from the audience.

One final note, my understanding is that this will be Peter's last public speech before stepping down at the end of the week, so let me just say we're particularly gratified to have you speak here at this time. And on behalf of all of us, I want to take the opportunity to thank you, Peter, for your outstanding public service to the nation, and welcome you back both to civilian life and to this institution, where you'll always be welcome. Thank you.

MR. ORSZAG: Thank you, Bill, for that kind introduction, and it's a pleasure to be back here at Brookings among friends and former colleagues. I think it's particularly appropriate that I give my final speech as OMB Director here, considering how much this institution did to help develop my thinking on a wide range of public policy issues.

Even before the President took office and I was sworn in as OMB Director in early 2009, the economics team was working day and night to mitigate the effects of what threatened to be a second Great Depression. And in the initial days of the administration, the dedicated staff at OMB did the work of six months in six weeks by putting together the President's first budget, the document that would lay out the blueprint for the President's first term.

From there, we worked on health care, education reform, eliminating unnecessary military weapons programs while providing necessary funding for our troops, and the list goes on and on and on. I'm not going to go over each of these initiatives, but I do want to discuss three topics in somewhat more detail, the Recovery Act, health reform, and our efforts to modernize government, all of which will have an impact not only for years, but potentially for decades to come. Let me speak about each of them and then I'd be delighted to take your questions.

Our first priority coming into office was to respond to a collapsing economy. Just to remind ourselves of how stark the situation was, considering the following: total private sector borrowing declined by a stunning 43 percent of GDP between 2007 and the first quarter of 2009, falling from 28 percent of GDP to negative 16 percent.

In 2009, the projected gap between how much the economy was producing and how much it could produce amounted to an astonishing $1 trillion. Given all of this, our immediate task was to increase aggregate demand and spark economic growth as quickly and efficiently as possible. In only 28 days after taking office, which, by the way, is much shorter than the so-called inside lag is often feared to be, the Recovery Act was signed into law by the President. And despite what many pundits might assert, most serious analysts agree that the Recovery Act helped prevent a further deterioration in the economy and played a key role in the economic growth we see today.

For example, Congressional Budget Office estimates suggests that the Recovery Act raise real GDP in the second quarter of this year by 1.7 to 4.6 percent, and in no small part because of that boost, the economy has grown for 3 consecutive quarters and created nearly 600,000 private sector jobs in the first half of this year. Not good enough, but a stark contrast to the 3.7 million lost over the first half of last year.

And just this morning, a new paper by Alan Blinder and Mark Zandi has been released which combines all of the various interventions to prop up the economy, and they conclude that without those various interventions, including the Recovery Act and the efforts to stabilize the financial system, real GDP would be 6.5 percent lower today, and there would be 8.5 million fewer jobs than we have. Very astonishing conclusions.

So if you can just remember what the mood was like in late 2008 and early 2009, if you can remember how it felt that we were on the brink of a second Great Depression, and you compare that to today, even with all of the challenges we continue to face, I think the only conclusion that one can reach is that there has been a very significant turnaround. So we are back from the brink, but not out of the woods.

The most pressing danger we now face is unacceptably weak growth and persistent unemployment rather than outright economic collapse. More needs to be done especially to revive the labor market for the millions of Americans who want to work, but are not able to find work.

That is why even as the economy grows, the administration supports additional targeted measures to boost job growth, such as additional aid to states to prevent the layoffs of teachers, cops, and firefighters, and support for lending to small businesses, to name just two. This will help those who are unemployed and help to spark job creation.

Now, what about the fiscal deficit? I think there has, unfortunately, developed a false debate between jobs and the deficit. The debate is poorly framed because, as in many things in life, it's all a matter of timing. It would be foolish to dramatically reduce the deficit immediately because that would choke off the economic recovery before it had a chance to develop adequately. But it would be equally foolish not to reduce the deficit significantly by say 2015, because that would seriously imperil economic growth at that point.

More specifically on the budget deficit, along with the gap between what the economy was producing and what it could produce, we came into office facing an historic budget gap: $1.3 trillion or 9.2 percent of GDP on the day the President took the oath of office.

As the economy recovers and we begin to phase our temporary job creation measures, the deficit is projected to decline to about 5 percent of GDP by the middle of this decade. That would be the fastest deficit reduction during any period since the end of World War II.

In addition to the deficit reduction that will come from economic recovery, the budget proposes policies to generate an additional 1 percent of GDP in deficit reduction. These policy changes will reduce the projected deficit from 5 percent of GDP to about 4 percent in 2015.

They include a three-year freeze in non-security discretionary spending; an end to subsidies for oil, gas and coal companies and other tax loopholes; and the expiration of the 2001 and

2003 tax cuts for those making more than $250,000 a year, which in and of itself would reduce the projected deficit over the next decade by more than $700 billion.

The President has taken three other key steps to guard our fiscal future. First, he signed into law statutory pay-as-you-go legislation. That enshrines into law the simple proposition that increases in mandatory spending or tax cuts should be offset by reductions in mandatory spending or revenue increases. It is no coincidence that when PAYGO was in place during the 1990s, the atmosphere of fiscal discipline it helped to engender was key in shifting the nation from deficits to surpluses.

Second, the President has created a bipartisan Fiscal Commission to recommend policies, to achieve medium-term fiscal sustainability and meaningfully improve the long-term fiscal outlook. The work of the Fiscal Commission is now underway, including this morning. And if you know Erskine Bowles and Alan Simpson, which I know many of you in this room do, you know how serious they are in tackling this undertaking. Their report at the end of the year will be a critical kick-start to the bipartisan effort necessary to restore our fiscal discipline over the medium and long term.

Finally, a crucially important opportunity to shore up our long-term fiscal future is embedded in the recently enacted Affordable

Care Act. As I have often said here at Brookings and at the Congressional Budget Office and at the Office of Management and Budget, the single greatest driver of our long-term deficit is the rising cost of health care. We cannot put the budget on a sustainable path in the coming decades without slowing this growth. We cannot cut other spending or raise revenue enough. The math simply does not work in any viable way.

And although you may not know it from the popular discussion of the Affordable Care Act, the legislation includes the most promising set of changes ever enacted into law to reduce the rate of health care cost growth over the long term. These changes include a new excise tax on the highest cost insurance plans, providing employers with an incentive to seek higher quality and lower cost health benefits; beginning to reform the payment system so that it rewards quality rather than quantity; and the establishment of an Independent Payment Advisory Board in Medicare so that reforming the health care system is not a one-time event, but an ongoing process with the goal of improving care and lowering costs over time.

In its official score of the Affordable Care Act, the Congressional Budget Office found that the law would reduce the deficit by more than $100 billion or 0.1 percent of GDP over the next decade, and more than $1 trillion or 0.5 percent of GDP in the decade thereafter. These savings will help to improve our bottom line over the next 20 years.

But the more fundamental and important question is, what happens over even longer periods of time? This is important since, by design, the act was created to have its budget savings increased more substantially over time than its cost, producing a rapidly growing wedge of deficit reduction over time.

We now have more information about these longer term effects. Last month, CBO issued a report on the long-term fiscal outlook, and the report suggests if the Affordable Care Act is fully implemented, it will reduce the 75-year fiscal gap -- by about 2 percent of GDP over the next 75 years. And keep in mind that this CBO analysis may underestimate the full impact of the Health Reform Act. In particular, CBO arbitrarily assumes that a number of the savings measures incorporated into the Health Reform Act, most importantly that Medicare Independent Payment Advisory Board, are turned off starting in 2030. If instead they continue to operate to limit cost growth in Medicare as the law requires, the deficit reduction would expand by another 0.5 percent of GDP, bringing the total to about 2-1/2 percent of GDP.

Now, last year, CBO put the 75-year fiscal gap at about 8 percent of GDP, so that 2-1/2 percentage point reduction means that the

Health Reform Act would reduce the long-term fiscal gap facing the nation by somewhere between a quarter and a third if it were fully implemented. A very substantial change.

Now I keep emphasizing “if it were fully implemented” on purpose, because achieving this deficit reduction requires that the act be implemented effectively. Indeed, the CBO report included an alternative scenario in which many of the act’s provisions are curtailed starting earlier and, not surprisingly, the estimates show that most of the deficit reduction has been eliminated. In short, mere enactment is not enough. As the CBO figures illustrate, implementation is essential. My point only is that the law includes the most promising set of potential reductions for future health care cost growth that has ever been enacted.

And it’s worth comparing this approach to the other proposals that are out there to reign in health care cost growth because those opponents of the law often put forward alternatives, and I think they are worthy of scrutiny. Take, for example, the plan proposed by Congressman Paul Ryan. Now, let me be very clear: I view Mr. Ryan as a friend and I have substantial respect for his work as a policymaker, but I believe his plan is fundamentally flawed. The reason is that starting in 2021, the plan would replace Medicare as we know it. In its place it would hand new enrollees a voucher to purchase health insurance in the private market. Over time, the voucher would increase far more slowly than projected increases in health care costs, and seniors would be asked to cover the widening difference in costs.

Now, proponents of this approach suggest that it would lead patients to push for lower-cost, better-quality care. In particular, proponents envision seniors going out and buying high-deductible health insurance plans, insurance plans in which they would pay out-of-pocket for regular medical expenses and insurance would only cover higher-cost catastrophic situations. The logic goes that such plans would encourage seniors to shop among doctors and treatments and rationally economize on their health care spending. The core problem, however, is that the bulk of health care spending is concentrated among those with serious illnesses and high health care costs.

For example, CBO found that in 2001, high-cost Medicare beneficiaries -- that is the top 25 percent of Medicare beneficiaries ranked by their costs -- accounted for 85 percent of total Medicare spending. For such high-cost patients, high-deductible plans would do little to change the delivery of health care since the patients would rapidly run through their deductibles, and most of their costs are above those levels.

Indeed, in the context of traditional health plans, CBO concluded that even universal high-deductible plans would reduce costs by only about 5 percent relative to conventionally designed PPOs and not reduce costs at all relative to HMOs. If the Ryan plan does not succeed in significantly reducing health care costs over time, because most such costs would not be subjected to higher consumer cost-sharing, how does it achieve its budgetary savings?

The answer is simple. The plan mechanically cuts Medicare by increasing its vouchers more slowly than health care costs. The result is that most of the budget savings would come simply from shifting more and more cost and risk onto seniors without substantially altering the overall course of health care costs. And that raises a key question of whether the plan, even if it were desirable, would even be politically sustainable.

The Affordable Care Act, by contrast, takes a different approach to reducing costs. It recognizes that the key to constraining health care costs involves those high-cost cases and that in those cases, the role of the provider is central. It, therefore, preserves seniors' coverage and instead focuses on reforming information and incentives for medical care providers so that they are encouraged not simply to provide more care, but instead to provide better care.

Admittedly, no approach is perfect, but I strongly believe that the approach adopted in the Health Act is better than any plausible alternative that has thus far been put forward.

To be sure, even with enactment of the Affordable Care Act, we remain on an unsustainable fiscal course. More needs to be done, but the bottom line is that after years of going in the wrong long-term fiscal direction, the act changes our course by enacting substantial long-term deficit reduction, deficit reduction that this administration is committed to implementing and building on.

Finally, I'd like to discuss the work that we have done at OMB to make government work better. Our efforts to modernize government may not get the front page headlines of health reform or the Recovery Act, but they are crucial to giving Americans a government that is more efficient and responsive to their needs. Fundamentally, the President believes that regardless of whether the budget is in surplus or deficit, the public deserves to have their funds spent in a way that is efficient and effective to deliver high-quality services at the best price possible.

It should be no surprise that we came to office facing a deficit here as well. According to the Pew Research Center, about two-thirds of Americans believe that when something is run by government, it is usually inefficient and wasteful. And, unfortunately, in many cases the public perception reflects reality. In too many examples, the government spends money not out of need, but out of inertia.

A significant part of the problem is that the government has been slow to adopt the technologies and methods that have made the private sector more productive over the past 15 to 20 years and have been responsible for delivering the kinds of services the American people have come to expect and deserve. Allowing this to continue would be an abdication of our responsibility as policymakers, which is why the administration has laid out an ambitious agenda to modernize government, one on which we have made some real progress, admittedly not very well noticed, over the past few months.

First, we're going after programs that are outdated, duplicative, or just don't work. In both the 2010 and 2011 budget, the President proposed approximately $20 billion in terminations, reductions, and savings. These cuts range from the F-22 fighter jets that the Pentagon said it didn't need or want to a radio navigation system for ships that has been replaced by something called GPS. And while recent administrations have seen between 15 and 20 percent of their proposed discretionary cuts actually enacted, we work with the Congress in Fiscal Year 2010 to enact 60 percent of our proposed discretionary reductions.

To move this process along for the Fiscal Year 2012 budget, we ask every agency as part of their budget submissions to identify the programs that are least critical to their advancing their agency missions. We've put in place a process also to get rid of excess federal real property, the buildings and land that the federal government owns, which will save $8 billion next year.

To remove obstacles for either the Executive or Legislative Branch to cut wasteful programs, the President also proposed an expedited rescissions authority to give Congress and the President a new tool to quickly consider and cut unnecessary and wasteful spending. And we've also put forward a plan for new transfer authority to create an incentive for agencies to cut waste as they implement programs.

In addition to this, and as we cut programs that don't work, we also need to make sure the programs that do exist don't waste money in big or small ways. For example, we're targeting improper payments. Last year the federal government made $110 billion in improper payments, payments that go to the wrong person for the wrong amount or at the wrong time. And over the past 3 years, federal auditors have reported that the government paid out benefits totaling more than $180 million to approximately 20,000 Americans who were dead, and more than $230 million in benefits to approximately 14,000 fugitive felons or those in jail and who were not eligible for benefits. I'm not making this up.

So we established a goal of reducing improper payments by

$50 billion between now and 2012. To do this we're setting up a central federal government Do Not Pay list. We're expanding recaptured payment audits, which is a tool that's been used in the private sector effectively; improving our methods for processing payments; and we're creating online tools so the public can hold agencies accountable for how their money is being spent.

We've also worked with Congress to pass the Improper Payments Elimination and Recovery Act, which the President signed into law last week. This bill will improve the reporting and oversight of those improper payments and give us new tools to stop them and save taxpayer dollars.

We're already seeing some successes. The Department of Agriculture, for example, recently reported a drop in payment errors in the Supplemental Nutritional Assistance Program, which previously had been known as Food Stamps, a reduction that avoided $330 million in errors. We're also working to cut ways and save money in contracting. And we're also working to reduce the number of high-risk contracts over time by at least 10 percent and changing how we bid for goods and services, finally using the purchasing power of the federal government to get a better deal for taxpayers. For example, earlier this year we used government's purchasing power to save about 20 percent on office supplies, which will save about $200 million over the next 4 years. That's an awful lot of pencils.

Finally, to bring real efficiency to the federal government to give us the best chance of preserving waste -- preventing waste, I'm sorry -- preventing waste in the first place -- no one's in favor of preserving waste -- we're working hard to close the IT gap and bring the federal government fully into the digital era. Although information technology has transformed the private sector over the past two decades, the federal government has been lagging behind, wasting billions of dollar a year and missing out on potential productivity improvements.

Working with our federal CIO and CTO, we've moved aggressively to begin bridging this IT gap. We're overhauling how we manage IT projects. Across the federal government, we are working agency by agency to identify troubled IT projects and to halt turnaround or terminate the worst performers. And we're using IT itself, specifically graphically rich and easy to understand dashboards and websites, to bring new transparency to IT spending.

Our IT dashboard has helped us track the progress of numerous IT projects and enabled us to conduct more than 30 reviews with agencies. We've already cut tens of millions of dollars in duplicative or unnecessary IT projects as a result.

Following the private sector's lead, we're consolidating data centers across the federal government, including the immediate implementation of a zero growth policy that will increase efficiency and reduce spending.

We're also making a major push to reform the IT we develop for the government's financial administration systems which are often the most behind schedule, over budget, and ineffective. We've frozen all new work orders for these projects, and we are reviewing each of them for feasibility and for their scope. We're developing new guidance to better govern how we use IT across all parts of the government.

Getting a jump on this process just last week, the Veterans Administration killed the financial management IT system that they tried to launch twice and they were unsuccessful in launching both times. The savings: $300 million.

Using IT is not only critical to making government more efficient, it also can make government more responsive to the American people. In almost every facet of our lives today, you can use online and mobile devices, whether you type quickly or slowly on such devices, in managing your money, paying a bill, buying a birthday gift, or arranging for travel.

We need to bring that kind of convenience to government service. That's why the Department of Homeland Security has added an online tracking service for visa and citizenship applications, replacing the old system in which letters were mailed back and forth when people wanted an update on their status. It's why we launched a mobile AP Store on a retooled USA.gov website to provide to the public applications that could help them find out how many calories are in the food they eat, what toys have been recalled and how long the wait is in the TSA line at their nearest airport. We have this information, and it's the responsibility of government to deploy it in a way convenient and helpful to the American public.

As I close my tenure at OMB, let me say it has been a high honor to serve this President in this administration. Teddy Roosevelt once said that, far and away, the best prize that life has to offer is the chance to work hard at work worth doing. And I thank the President for giving me that prize.

I look back over this past year and a half proud of the work we have done to rescue the economy from a potential depression, to expand health care coverage while providing the infrastructure to deliver better quality at lower cost over time, and of our efforts to improve the functioning of our federal government.

I leave office confident in the leadership of the President and his team to push ahead on these important initiatives, and I look forward to continuing to support him and my colleagues in that ongoing effort.

Thank you, and I'd be delighted to take some questions.

(Applause)

I think we're going to ask people to identify themselves and actually ask a question.

Mr. Gale.

MR. GALE: Thank you. I'll start this all off. Thank you, Peter, for those remarks.

Back to the budget -- although the comments on the management were very interesting -- back to the budget, the two moving parts that people talk about most often are tax cuts and entitlement spending. But the other big moving part on the spending side is the defense budget.

I was wondering if you could say something about what the administration is doing there to cut spending or refocus spending.

MR. ORSZAG: Thanks, Bill.

And actually, this is another, I think, largely untold story. If you look at the draft future-year defense plan that the military had developed before the administration took office, which was widely disseminated in the trade press, and compare that to -- it was never formally published, but it was somehow release to the media. If you compare that to the course that we are now on, you see that relative to that wish-list future-year defense plan, defense spending over the next 5 years is projected to be $300 billion lower than under that draft future-year defense plan. That's a very substantial shift.

And I will say that during the transition, in our internal documents, we were hoping to match, basically, the path that we were on. And I remember one of the big risks that would be identified in the fiscal discussions was that that was not politically viable or that was not realistic. We have succeeded.

Similarly, I think there was a lot of skepticism that we would succeed in canceling the F-22 and the presidential helicopter. That happened.

So there's been a lot of progress made, especially on the weapons side of things. More needs to be done. But I think another untold story is that the course that we were on with regard to military spending has been very significantly altered, in no small part due to the leadership not only of the President, but of Secretary Gates.

How about there, in back?

MR. LOPEZ: Yes, hello. Yeah, my name is Rick Lopez, and I work with LPAC. I just want to say, I've always been inspired by beancounters who are willing to come out and impose really brutal austerity, and yeah, it's gonna butcher the poor, but, y'know, whatever. My question is, what do you think of this song that was inspired by you that I wrote? It goes: [singing off mic] [inaudible]

MR. ORSZAG: I clearly chose the wrong person for the second question.

[laughter]

MR. ORSZAG: Ruth Marcus. Now for something different. All questions must be in song.

MS. MARCUS: Thanks. Ruth Marcus, from *The Washington Post.*

On the question of the expiring tax cuts, Peter, could you address a few things? On the one hand, the suggestions from Majority Leader Hoyer and others that perhaps it would be wise only to extend the expiring cuts on the lower brackets for a few years. The arguments on the other side, from Senator Conrad and others, that it might be a good idea to extend everything, including the upper bracket cuts for a bit.

And on that question, would the President veto a measure that included extending the expiring upper bracket cuts? And since I suspect you might duck the question of “will he,” would you recommend that he should?

MR. ORSZAG: Ruth, I did happen to read your column this morning, so I know where you stand on all of these issues.

I'd say a couple of things first.

MS. MARCUS: (inaudible) the column?

MR. ORSZAG: I'm sorry? I'm not going to sing the column. But I'm sure the *Post* would love to post your version of the column in song.

The administration has been very clear about what we favor, which is what's embodied in our budget, which is continuation of the middle-class tax cuts, but allowing the high-income tax provisions to expire. And that's the administration's position, period. So while there are lots of policymakers out there with different ideas, I think we have been clear about what it is that we prefer.

The only thing that -- and I think I'm going to leave it at that. I'm not going to be in a position to recommend to the President whether he veto or not since I will be a private citizen at the time. But thank you for that question.

MR. LOVELL: Malcolm Lovell, Brookings Advisory Council.

Has any thought been given to helping medical costs be part of the market economy, such as requiring doctors to post online what they charge? In the years I've been going to doctors, there's been no competition between them. You go to a doctor, and if can't see you anymore, he recommends somebody else. And has any thought been given to that?

MR. ORSZAG: Well, I think there are two components to -- or several components to more competition or more market-oriented activity in health care. One is information. And there is now a movement towards -- including in the legislation -- a movement towards more transparency on pricing, which I would agree with you, historically has been quite opaque to consumers.

The second part of the debate is often the one that I discussed, which is proponents of high-deductible health plans, believing that what we need is more consumer skin in the game. And, again, the analysis from CBO suggests that while that can help a little, it doesn't help as much as you would think, and it's certainly not a panacea because so much of health care costs are in the high-cost and catastrophic cases. And the whole point of insurance is to protect against those high-cost catastrophic costs, so there's an inherent limit to how much traction you get from that approach.

And I think that's actually a very important point, which is -- I have read some of the criticisms of the approach adopted in the Health Reform Act, and what I would ask of those skeptics or those critics is:

What is your alternative? If the alternative is simply the high-deductible approach, if that were subjected to the same scrutiny, I think it would come up -- fall far short of what needs to be done.

So I think, again, the question has to be asked, while nothing in life is perfect, I think the basic logic and structure embodied in the Health Act makes a lot of sense, and we now need to implement well on its potential.

Jonathan Weisman.

MR. WEISMAN: Jonathan Weisman of *The Wall Street Journal*.

Peter, I'm wondering why you think it is that opinion polls seem to indicate that Americans, at a time of high unemployment, have fallen in love with the notion of deficit reduction?

And do you think that Americans really are ready, or voters are ready, to do the painful things that are necessary over that medium term you were talking about -- through 2015? Or do Americans still believe that waste, fraud, and abuse and foreign aid will do the trick?

MR. ORSZAG: Well, look, I think, again, since I'm not a political scientist, let me just stick with the substance. And I think the substance is, it's all a matter of timing, as I tried to mention in my talk. Even the most progressive, Keynesian-oriented person who's concerned about our short-term economic situation needs to acknowledge that over the medium and long term we are on an unsustainable fiscal course. And ultimately, those projected deficits, if they're not addressed ahead of time, will cause substantial economic harm.

And similarly, even the harshest fiscal hawk has to acknowledge that in an environment of unemployment above 9-1/2 percent, when more aggregate demand would be beneficial, it would be helpful, if possible, to have more support today.

So the right combination is more fiscal discipline in the medium and long term, and more support for the economy in the short term. And both sides need to acknowledge that.

Again, I'm somewhat frustrated by the way the debate has evolved, because it's almost like it's either one or the other, when we need both. And it's all a question of timing. And frankly, I think the public probably perceives that, also. That is to say, immediate concerns over unemployment, but also legitimate concerns over the medium- and long-term fiscal course that we're on.

Right behind Jonathan.

MR. LYNCH: David Lynch, with *USA Today*.

Peter, to pick on the timing question, the folks who argue for more urgent action on the deficit say that even though investors now don't seem too worried about it -- bond yields being quite low -- that there's the danger of a sudden shift in market sentiment that could cause a fiscal crisis well short of your medium-term or long-term expectation. How real of a danger do you see there?

MR. ORSZAG: Well, look, the reason the President set up a Fiscal Commission, even when the 10-year bond rate is at 3 percent, is precisely to get ahead of the problem. Another way of putting the same point is, that collapse in private-sector borrowing that I mentioned -- and I think this is really astonishing, a more than 40 percent of GDP shift in total private-sector borrowing between 2007 and early 2009 -- eventually will turn around as the economy recovers.

Right now, in a sense what's happened is private sector demand and private sector borrowing imploded. The Treasury Department was the last borrower left standing. The result was very low yields on government bonds, even while the deficit expanded, both in response to the economic downturn and the measures necessary to counter it.

Eventually, private sector borrowing will pick up again, and then you're going to see much more significant upward pressure on government interest rates, which can happen either gradually or, as the Congressional Budget Office pointed out in a brief that it released yesterday, unfortunately, can sometimes happen much more suddenly. And that's your point.

But as CBO also noted -- and I agree with this completely -- it is impossible to predict when that would happen. I think we are in no immediate danger of it happening. But one of the strong motivations for acting sooner and quickly is to mitigate the risk that it does happen.

Right here in the front.

MR. MOODY: Jim Moody. Back to the health care issues and particularly using market forces, two respects.

One is, having lived in Italy during a period of time, when the same drug was about 30 percent of the cost here, obviously there's some issue about drug costs these days. And how do we get -- how you can get the right incentives in place to bring those down to more like marginal costs, or something approaching marginal costs, as opposed to having a huge slice.

The second is about the doughnut hole and whether or not market forces should have been allowed to work. Because that was the -- the whole -- the concept of the doughnut hole was to let market forces force people to put pressure on pharmaceutical prices.

Is the doughnut hole now being closed? Is that -- are we abrogating market forces there? Or to what extent are those forces still at work?

MR. ORSZAG: Well, first, I'm not positive that that was actually the motivation behind the doughnut hole. I think the doughnut hole was created in part because they needed to fit something within budget constraints, and that was one way of doing it.

Second, with regard to pharmaceutical pricing, there are measures that can be taken to try to help to constrain cost growth over time, and those are beneficial -- some of which are embodied, again, in the Health Act. But I think it is worth noting that pharmaceuticals are only about 10 percent of overall health care spending, so that is not where the majority of costs are located.

So progress is possible, but it's not where the money is.

How about over here?

MS. OLOPADE: Thank you. I'm Dayo Olopade. I'm with *The Daily Beast*, the New America Foundation.

You mentioned the, I guess, sort of retroactive solution of providing state aid to keep -- you mentioned teachers in schools and cops on the beat. I distinctly remember, during the passage of the stimulus, the excising of about $40 million in state aid at that time.

I wonder whether you believe that the stimulus was large enough? What you would have done differently in that moment, knowing what you know now? And sort of more generally, how you feel the types of political constraints that you might have faced in your present position generally affect the discourse and might be different in the future.

MR. ORSZAG: Well, first, let me comment on the Recovery Act, because I know there's been a lot of discussion, especially on the left, about whether the Recovery Act should have been bigger. And while I am sympathetic to that argument, I think it's also not even remotely within the politically viable range.

I was in the room when that was being negotiated, and I can personally guarantee you that I see no -- 0 -- 0.000 probability that it could have been any substantially larger. And I am actually pleased that it was as large as it was. In other words, I think we did the best that could have been done without significant delay.

And there's a tradeoff. Again, 28 days after taking office, that was signed into law. There was a desire -- and, I think, an imperative -- to get something signed into law quickly so that you could start to stop the bleeding as rapidly as possible. Any attempt -- from my perspective, any attempt to have gone much, much larger undoubtedly would have been unsuccessful, and undoubtedly would have led to very substantial delay.

So within the realm of the politically feasible, I think this was about as good as could have been done, even though were I back at Brookings, I would have been writing papers about how this or that could have been done differently.

How about over here?

MR. BESTANI: William Bestani, Kirkland & Ellis.

Much of the funding that was actually in the Recovery Act did go to various states to prevent, you know, draconian losses of state and government workers. I'm kind of curious, what are the administration's estimates, if none of that funding is replaced, for what the level of state and local government job loss is going to be? And are those appreciably lower than the estimates would have been, say, that had the funding never been provided as part of the Recovery Act?

MR. ORSZAG: It is unquestionably the case that the Recovery Act helped to mitigate and prevent layoffs that would have occurred at the state and local level. Projected deficits for this year and next year at the state and local level are on the order of about $140 billion a year, and that's going to be one of the forces that will impose a drag on the economy over the next year or two. There are others that we could discuss.

And so, bottom line -- and actually coming back to the earlier question -- many of the layoffs, for example, with teachers, actually haven't happened yet. As school goes -- as kids go back to school, if there is no significant relief provided, I think we're going to be seeing a much more dramatic set of circumstances in the fall. And it would be unfortunate if we were not providing relief now to prevent that from happening on a prospective basis.

And then backward-looking, there were significant benefits from the funding that was provided both through FMAP and other mechanisms to assist states that helped to prevent layoffs and job reductions at the state and local level.

How about over there?

MR. GUGGENHEIM: Hi. My name is Joe Guggenheim. I'm a private citizen, once an economist.

It seems to me one of the major issues that hasn't been given enough attention in the whole question of the future of our economy and deficit problems is promoting higher economic growth as something that in the long run can really make a difference. And I think our country's had an anemic rate of economic growth recently.

And I think my initial impression is the 2015 projection, where the President is proposing a cap on discretionary spending, isn't going to be helpful in that regard, particularly when I think one of the major things we need to do in terms of economic growth stimulus is infrastructure, education, community revitalization.

So I wonder if you'd comment on that --

MR. ORSZAG: Sure.

MR. GUGGENHEIM: -- and your feelings about what we can do for better economic growth.

MR. ORSZAG: Well, note that -- let's take the 2011 budget as an example. It achieves an overall, non-security discretionary freeze. But even while accomplishing that, it invests -- it has a 6 percent increase in education spending, a significant increase in research and development spending.

So what the President is trying to accomplish is an overall freeze in non-security spending, but continuing to fund the priority items that are crucial to long-term economic, including, for example, research and development and education, which are not only protected, but actually increasing.

And so what you're doing, in a sense, is moving resources into those areas I think exactly along the lines that you're favoring.

I think this will be the last question.

Lori.

SPEAKER: Peter, back on the deficit for just a minute. Given that the source of the biggest spending cuts are the entitlement programs, and given that cuts to those programs are unlikely to have much deficit impact before 2015, can your successor reach the President's 2015 deficit goal without a significant tax increase?

MR. ORSZAG: Look, I think the balance between spending and revenue is one of the many things that the commission is examining. I think it is -- we have been very careful to leave all options on the table on purpose, so that the commission can explore not only the proper balance between spending reductions and revenue increases, but also the specific elements within each of those categories. And that was done on purpose, and with the thought that our best hope of tackling our medium- and long-term fiscal problem is if it's done on a bipartisan basis. And that's precisely why the President set up the Fiscal Commission.

Let me just, again, thank Brookings for welcoming me, and thank you all for coming. (Applause)

MR. GALE: Peter, thank you very much for your patience as we experimented with temporarily waving the no-singing rule at Brookings events. And thank you, as always, for your candor and insight and all your public service.

Thank you. (Applause)

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

/s/Carleton J. Anderson, III

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