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# THE POLITICS OF ENTITLEMENT REFORM AND THE BUDGET DEFICIT

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P R O C E E D I N G S

MR. HASKINS: Welcome to Brookings. Thanks for coming. My name is Ron Haskins and, along with my colleague Belle Sawhill, I run an organization here called the Center on Children on Families. And we also run another organization as part of our Center called the Budgeting for National Priorities, and we've been conducting activities for almost a decade. The kind of things that scholars do, especially focused on the federal budget deficit.

And our goal has been to do three things, really. First, sound the alarm. There's a deficit out there, it could hurt us, we need to do something. Secondly, to propose specific solutions for what we should do about the deficit. And third, to agitate. And we've been doing all these things for many, many years. We've joined with other organizations in town, other think tanks and organizations. We've published three books, we've published numerous articles, op-eds, testified, we've tried to organize what you might call information sessions for senior staffers and members of Congress and members of the administration. We've met personally with lots of senior officials. So, we've done everything that we could think of to do within the boundaries, roughly speaking, of the scholarly world to try to bring attention deficit in to get somebody to do something about it.

So, as you might imagine, now is a time that we are really enjoying it. It looks, at last, as if people have actually recognized that we have a deficit. And not only that, but we have several compelling plans on the board. And of course, nobody agrees with everything on any of the plans. But I think so far it's been remarkable how much at least the analysts have accepted these plans and realized that they're very serious efforts and that something roughly along these lines is required in order to solve the deficit.

I was in a meeting at the Urban Institute the other day with 18 kinds of Washington insiders, very senior people. And Bob Reischauer ran the meeting and we had an hour and a half of criticism of the plans and this is wrong and so forth. And at the end, Reischauer said, "okay, how many people would support the plan with modest changes or not?" Eighteen to four support the plan. So I think there's a lot of support for plans like this, not necessarily like the one that was on the President's commission or the chairman of the commission's plan. But I think there's a lot of support in the analytic world that we can -- and confidence that we could get to a good plan.

So we plan to continue our activities about analyzing these plans and putting forth good criticisms and possibly improvements in the plans. And that's our goal today.

So we have two purposes here today. The first is to help all of understand the plans, and Belle Sawhill is right at the beginning going to give a brief outline of the two plans. One plan is, I think they're probably still in their event or finished just a few minutes ago. So we haven't done as good -- as careful analysis of that. But they're already very nice analyses. One by the Center of Budget and Policy Priorities that I believe is available outside. So we want to understand the plans.

And then secondly, we want to analyze them and make specific proposals for how they could be improved. Obviously, the proposals for improvement are going to differ quite a bit, depending on who you're talking to.

So in this event, here is how we plan to conduct ourselves. First, Belle and Greg Anrig from The Century Foundation are going to reprise, briefly, their recent debate on the deficit and entitlements that was published in *Democracy*. I think all of us have moved a little bit away from our original agenda because of all the new plans that have been put on the table. So we'll focus on the plans as well as on that debate. And as I already said, Belle will give a brief overview of the two plans at the beginning of her presentations.

Then we're going to have comments from four distinguished analysts, roughly divided left of center, right of center. And then I'm going to ask them some penetrating questions and then it will be the audience's turn to ask questions.

So that's our order of events today. And let's start right away with Belle Sawhill.

MS. SAWHILL: Thanks very much, Ron. And welcome to all of you. There is just a tremendous amount coming out in terms of plans to reduce the deficit now. And so as Ron suggested, we are going to move away from our original plan to just to discuss the debate that -- very, very good and interesting constructive debate, I think, that Greg and Rick and I had in the pages of *Democracy: A Journal of Ideas*. But you can pick up our debate, a copy of our debate, out on the table.

So what I'm going to do is focus less on that and more on the proposals and the controversies that I think they raise coming out of these two commission reports. The Domenici-Rivlin report that's just being released today, and the Bowles-Simpson report, the co-chair's report that came out a few days ago.

Let me start with some premises that I think these commission reports lay out. And that most of us could probably agree to, although with different degrees of emphasis. First of all, the fiscal challenge is very large.

Secondly, you shouldn't cut spending or raise taxes in the middle of a recession, although I think many of us would argue -- I certainly would -- that we should enact measures as soon as possible to send the right signal to financial markets that we're getting our fiscal house in order.

Third, everything needs to be on the table. The problem is too big to do it with just one portion of the budget.

Fourth, health care spending is the big enchilada. Social Security needs to be put on a path to solvency, but it's not nearly as big a problem as health care. Next, we need to curtail tax expenditures. These are the deductions and preferences that are layered through the entire tax code and that are currently costing us roughly $1 trillion a year. Some of us have come to call these "backdoor spending programs." They disproportionately favor the wealthy, they impose an enormous compliance burden on the American public, and they reduce economic efficiency.

We also, I think, all agree that we need to look for savings in defense and the rest of the budget, not just in the revenue side and not just in the three big entitlement programs. Although the three big entitlement programs, which are Medicare, Medicaid, and Social Security, already absorb over 70 percent of all revenues that we are collecting right now. And they will, if left unchanged, move us into totally unsustainable territory.

Another, I think, common agreement is that we need to invest in programs that promote opportunity and growth, such as education, infrastructure, and research. So there's an argument to be made about freeing up some resources not only to reduce the deficit but also to make the nation stronger in these other ways.

I think we could all also agree that we need structural reforms in the way health care is paid for and delivered. That will enable us to get better value for our health care dollar. And finally, I think we need to preserve the core commitment to ensure people a decent income in their retirement years and access to basic health care, especially among those whose lifetime earnings have been low. And who are up there in the oldest segment of the elderly population.

So, if that's a kind of broad sense of where I think there's some consensus, let me now focus on a few more details and where there are likely to be disagreements.

First, and I think most importantly, the size and the immediacy of the economic and political risks associated with running continued deficits are not entirely clear. Many of us argue that they could produce a major economic crisis at any time. They make us dangerously dependent on our foreign creditors, they undermine confidence in government amongst the public, and they give us little flexibility to deal with any new crisis, should it be a terrorist attack, a double-dip recession, a natural disaster, or something else. So there's room for disagreement here about what those risks are.

We may also disagree on the right time to implement fiscal discipline. Can we afford to start the process in 2012, as Bowles and Simpson argue? Or is the economy likely to still be too weak to tolerate any spending cuts or tax increases that soon?

Both commissions are aware of this problem of not wanting to impede the recovery, but there will still be issues about when to initiate any fiscal discipline. And in addition, whether to combine the fiscal discipline with some new stimulus or job creating measures. In the Domenici-Rivlin proposal that's being released today, they call for a one-year holiday on payroll taxes for both employees and employers as a job creating measure. My own view is that we need to do both, have job creating measures and fiscal discipline.

Next, there will be continuing debate about the right balance between spending cuts and revenue increases. Leaving interest aside, Bowles-Simpson is 70 percent spending cuts combined with 30 percent revenue increases by 2020, whereas the Domenici-Rivlin plan tilts more toward revenue increases and is roughly a 50-50 split by 2020.

Another difference between the two commissions, and in the debate more generally, is whether we need a brand new source of revenues, such as a VAT, a value-added tax, a national sales tax, or carbon tax.

Bowles-Simpson includes no new taxes beyond the ones we already have. Domenici-Rivlin does call for a brand new tax. They call it a Deficit Reduction Sales Tax, but it is very similar to what most of us call a VAT. I think this is good political marketing to have given it that name.

One thing that both commissions agree on is that tax expenditures are a backdoor form of spending that can be curbed or eliminated in ways that not only reduce deficits, but also permit a reduction in tax rates. So, both commissions suggest radical reform of the current tax system with major curbs on these tax subsidies and lower rates at both the personal and the corporate level, much lower rates. I mean, in Bowles-Simpson the top income tax rate, for example, falls from 35 percent to 23 percent.

Now, whether the public will be willing to give up on all those tax subsidies like the Mortgage Interest Reduction or the Charitable Deduction is, of course, the big question. Both commissions challenge the notion that we can address deficits simply by doing the relatively popular things that members of Congress like to talk about. On the left, raising taxes on the wealthy; for everyone cutting unproductive fraud, waste, and abuse. Cutting earmarks -- on the right -- I mean, excuse me, on the left cutting a few weapons' systems and putting federal employees on a diet. Those are the popular kinds of proposals one hears.

The public, I believe, in fact is in denial about the scope of the problem and about the fact that that set of things isn't going to do the job. These cuts are going to have to be much broader and tax increases are going to have to be part of it as well. But that raises the question, how do we ensure that whatever sacrifices are made are fairly shared? For example, as both plans note, tax deductions -- these tax subsidies -- primarily benefit those in the upper brackets. But payroll taxes and VATs tend to be regressive, unless they're offset by refundable credits at the bottom.

Both commissions, I think, pay attention to these issues of fairness. They talk about them, and they call for an increase in Social Security benefits for low-income elderly and for the oldest beneficiaries. But I suspect many, including me, will worry about the deep cuts in domestic discretionary spending and how they are likely to affect lower income families.

Bowles-Simpson, by the way, cut these discretionary programs much more deeply than do Domenici and Rivlin.

On Social Security, both commissions restore to solvency over the next 75 years. They raise the level of earnings subject to payroll taxes, and they increase the retirement age or index it for increases in life expectancy, but only very gradually. They do also reduce the growth of benefits, again very gradually, for more affluent seniors. That means the top 25 percent in the Domenici-Rivlin plan and the top 50 percent in Bowles-Simpson. There is a hardship exemption proposed for those who have worked in manual jobs and may need to retire earlier. Now this set of proposals on Social Security has perhaps attracted the most attention, and especially a lot of opposition on the left.

Finally -- and I'm getting close to being finished here. How am I doing, Alex? Okay, all right. Finally, many are going to ask whether Obamacare, the health care bill that was just passed, can be expected to significantly slow the growth of health care spending over time? And, thus, solve a major chunk of our long-term deficit problem. Or whether instead we need to take a second bite out of the health care apple sooner rather than later?

Bowles-Simpson nibbles at the apple, but Domenici-Rivlin take a really big bite by putting health care on a fixed budget that shifts the default from automatic growth of health care spending to constrained growth. These kind of fixed budgets for health care can take two forms. One would be to create a defined contribution at the individual level, so-called premium support where one gives a certain amount of money to each individual to buy health insurance plan of their choice with the value of the subsidy, depending on your health status and your income.

Another option is a global budget at the national level for federally-funded and subsidized health care. This is what many other countries do, and there is hint of this or more than a hint of this, I guess I should say, in the Domenici-Rivlin plan. Shifting to a situation where health care cost growth is predictable and constrained, and in which providers might, therefore, be forced to find more efficient ways of delivering care and individuals might become better consumers paying more attention to the value that they get per dollar spent.

Well, I will stop there. Like everyone else, I've only been able to do a quick read of both of these plans. I think there's going to be a lot more analysis to come, and I think the discussion we're about to have will hopefully shed still more light on many of these issues.

Thank you. (Applause)

MR. ANRIG: Okay. All right, good morning everybody. I'm very happy to be here. I'm going to misbehave right off the bat and just spend a couple of minutes explaining why I think we're having the wrong debate, not just here at Brookings today but also in general in Washington with the release of sundry commission reports about cutting federal deficits.

Rather than prioritizing long-term federal deficits, which are a genuine and important problem, we should be concentrating on ideas for reinvigorating an economy that is still in terrible shape. Restoring broadly shared prosperity, as David Leonhardt writes in today's *New York Times*, would go a long way toward restoring the nation's fiscal health.

With the economy still in a liquidity trap after financial collapse, the federal government needs to spend more and only begin to pay down the debt after prosperity has returned. We are very far from that point.

Okay, this is a recent graph from the *Washington Post* looks a bit complicated, but it encapsulates the basic problem we currently face. It shows the so-called output gap, which is the difference between the amount of goods and services that the economy is currently producing -- the lower curved line, down there -- and what the economy could be producing if it were operating at full capacity. The difference is the shaded area, the brown area there.

Under full capacity, which we experienced for an extensive period of time before the Great Recession hit in 2007, almost everyone who wants a job can find one, machines are being put to full use, and office buildings are full. Today, though, with unemployment still at 9.6 percent, we are very far from full capacity. This graph shows that even if the growth rate were to rise and remain sustained at 3 percent a year, it would take until 2020 before we would fully close the output gap.

If the growth rate continues to putter along at around 2 percent a year, we will never close the output gap because of population growth and rising productivity. Both the Bowles-Simpson, and now the Domenici-Rivlin deficit reduction plans would begin to take effect in 2012, when employment is still likely to be around 9 percent. That would be much too soon.

That said, the payroll tax holiday idea that Belle mentioned that's in the Rivlin-Domenici report is certainly worth looking at, as long as the government credits the lost revenue to the social insurance programs.

The cost of borrowing to the government, now, is extremely low by historical standards. The interest rate on 10-year Treasuries is about 2.8 percent, it's about 4.2 percent for 30-year Treasuries. That's a totally different environment from the 1992 to 1993 period of Ross Perot's deficit charts and the Bill Clinton budget deal, when those rates were in the 6.5 to 8 percent range.

The Recovery Act clearly improved the job situation relative to what it otherwise would have been. Most economists think the unemployment rate today would have been 11 to 12 percent without it. But we're not acting to build on that success, because Congress is worried about deficits.

Keep in mind that the Recovery Act accounted for only about 3 percent of the projected 50 year long-term budgetary shortfall. Even non-liberal economists like Martin Feldstein and Jan Hatzius of Goldman Sachs have argued that the government should be spending more now to stimulate the economy.

I fully recognize that that seems politically hopeless at this point, but it would be constructive if these commissions and other deficit hawks would get behind the idea of urging substantially more spending now on the condition that serious deficit reduction steps would automatically be put in place after robust private sector employment growth resumes.

By the way, with respect to the payroll tax, holiday spending generally provides considerably more economic bang for the buck than do tax cuts, some of which are saved by people.

Okay, now that I've gotten that off my chest I'm going to start behaving and turn to the actual subject of our debate today, which is how to best reduce long-term deficits. I fully agree with Belle and all the commissions that the long-term fiscal outlook is highly problematic. That major policy changes will be needed to prevent debt to GDP levels from rising, upwards of 100 percent and higher in the next decade.

We all also agree that the expectations of continuation of rapidly rising health care costs are essentially responsible for those daunting budget forecasts. I'm relatively optimistic that the new health care reforms lay the groundwork for eventually bringing medical inflation down toward a more manageable level. But in any case, it's clear that actions will need to be taken to buy time until that point.

A central disagreement I have with these commissions is that while they think social insurance benefits should and must be cut, I believe that such cuts are neither desirable nor necessary to improve the long-term budget outlook. At the end, I will briefly summarize a few ideas about how that can be accomplished. But I want to mainly focus on why protecting social insurance programs should be the highest priority while valuating options for improving the nation's long-term fiscal condition.

Many people think the war on poverty was a failure, but the war on elderly poverty was a major success story. Before 1960, the poverty rate among the elderly was more than 35 percent. But expansions in Social Security coverage and benefit levels, including indexation of benefits to inflation, along with the advent of Medicare and Medicaid led to a huge drop in that rate to about 9 to 10 percent today. And look how flat this line is, even though ups and downs of the economy, which shows that the system is working as it should work.

That said, we still have 9 percent unemployment among the elderly. We could do better than that, but the main priority ought to be preserving a success story. This is a success story here, it's as good of a success story as the U.S. Government has ever had. And putting that at risk, I think, would be highly misguided.

This slide is from Bob Greenstein's organization. And the most important figure here is that without Social Security, poverty among the elderly would be 45 percent instead of just under 10 percent. But also note that mainly because of its survivors and disability insurance protections, large numbers of younger people benefit as well. The poverty rate among non-elderly adults would be about 3 percentage points higher without Social Security.

This slide shows the share of widows living alone, which rose from 18 percent in 1940 to 62 percent in 1990. While the shares of widows living with adult children declined from 59 percent to 20 percent. That's a huge increase in independence that has been closely studied and found to be almost entirely attributable to expansions in Social Security coverage and benefit levels. Contrary to what folks at the Cato Institute or Heritage will tell you, social insurance greatly increases individual freedom, enabling people to live independently when they otherwise would be reliant on other family members or friends.

Similarly, universal health insurance will ultimately enable workers to move much more freely from job to job without worrying about losing coverage. Social insurance gives people greater freedom to make choices about how to live their lives.

This *New York Times* poll from earlier this year demonstrates the popularity of social insurance, not only among the public at large, but even Tea Party supporters. Note that the question emphasizes the cost of the programs to taxpayers. Overall, do you think that benefits from government programs such as Social Security and Medicare are worth the costs of those programs to taxpayers, or are they not worth the costs?

Most of these people who were surveyed are paying taxes -- and a lot in taxes -- towards these programs, not yet receiving benefits. And yet you still get the support levels you see here, which I think is important. It's pretty hard to think of anything else the government does that would get close to a similar response.

Some people will say that it's misguided for policymakers to pander to public opinion that's so decisive, but I actually think the popularity of programs is worthy of a high degree of respect in a democracy. If the people who are paying the taxes are enthusiastic about the product and willing to pay for it, the government should be inclined to give them more rather than less of the same product, just as the private sector would.

So, in short, these programs have been highly effective at reducing poverty, improving the quality of life and economic security for all generations, offering greater independence and freedom to families, providing a modicum of social cohesion in a very fractious society. And they are highly popular. What's not to love?

Well, it turns out, not everybody does love these programs. Here's what

Alan Simpson, the co-chairman of one of these commissions, had to say. I hope you all can read it, I'd rather not repeat it, if it's okay with you.

Got that? Okay.

He took back that statement, not surprisingly, but the basic theme that social insurance programs are overly generous is central to the analysis of these commissions and people who are arguing that we should be cutting these programs. And they usually use less colorful language than that, but that's a basic thrust of everything we hear in these debates. My contention is that those programs aren't even close to overly generous.

All right, here we see how Social Security compares in relation to 30 other government-run OECD pension plans, focusing on the share of retired workers past earnings replaced by public pensions. For low-income beneficiaries we rank 26th between Poland and the Slovak Republic. For average earners, we're 25th. It's a little bit higher for upper-income workers, we're 22nd there.

The Bowles-Simpson and Rivlin-Domenici commissions are putting us in a direction of trying to get into 30th place, because they significantly cut back benefits relative to what we currently provide at this very modest level now.

This slide derives from the latest trustees report, and it shows Social Security retirement benefit levels in relation to past earnings. It conveys that the system is progressive in that it replaces lower shares of past earnings for those with higher incomes. It also shows that the dollar amounts are far from lavish. One thing I would point out is that those replacement rates are already scheduled to decline in the years ahead as the so-called normal retirement age increases from 66 to 67, which will have the effect of reducing benefit levels across the board.

Also, the Medicare Part B premium, which reduces net Social Security benefits, is going to rise. And more people will be subject to taxation of their benefits at higher levels. The impact of those changes is that for an average earner who retires at 65, the net replacement rate will decline from around 40 percent to 29 percent by 2030. That's without any further benefit cuts.

Okay, this is about Medicare now. A study -- this is a study that compares Medicare with a typical large employer-sponsored private plan, and the standard option for federal employees. For moderate cost beneficiary, individuals on Medicare owe far more out of pocket than do beneficiaries of the other plans, paying about 47 percent out of pocket -- that's this part here -- compared to 28 percent for a large employer and 21 percent for the federal employee's coverage.

That gap will probably be somewhat lower because of improved Medicare drug coverage under the health care bill, but the main point is that Medicare is not excessively generous relative to other plans, and that will still hold in the years ahead.

Medicaid, of course, is much stingier. It pays health care providers an average of only about 72 percent of what Medicare pays. And about a fourth of Americans eligible for Medicaid aren't even enrolled in it.

Just about all Americans have taken a huge hit to their net worth during this latest crisis. Experience really underscores the importance of social insurance. Millions of people who were counting heavily on their housing equity during their retirement no longer have nearly as much as they expected. Defined benefit pensions have largely disappeared, defined contribution plans have proven to be highly unreliable. Many people are at risk of significant net income losses due to major health care needs. The federal social insurance programs are really the only thing left that's proven to be reliable in a crisis like this, and if we have another one, you know, the vast majority of the public is going to be highly dependent on these programs.

So, as we know the budgetary problem is health care, health care, health care. Social Security is about 5 percent of GDP, and so is Medicare and Medicaid combined. Social Security is going to gradually climb from that 5 percent to about 6 percent over the next 20 years and stay there. In contrast, Medicare and Medicaid are expected to roughly double over that same period and continue expanding as a share of the economy ever after.

If nothing is done, Social Security will be able to pay out benefits in full until 2037. And even after that point there will still be sufficient payroll taxes coming in to finance 78 percent of promised benefits.

The projected shortfall of 0.7 percent of GDP over that 75-year period is roughly the cost of extending the Bush tax cuts for those earning $250,000 or more. That's a relatively small gap and a drop in the bucket compared to the main budget problems caused by health care inflation. But Social Security continues to be conflated with health care programs under the rubric "entitlements" misleadingly imply that they're in the same boat.

If all of this additional spending on Medicare produced better heath outcomes than was spent with a high degree of efficiency it wouldn't be such a major problem. But about a third of it is wasteful. The health care situation is not just a public sector problem or simply a budgetary one. And Obama was absolutely right to take it on for the sake of the economy as a whole, not just the federal budget. Private sectors bury the weight of this as well.

Here's a total tax revenue as a percentage of GDP. We're very -- again, at the very low end. You contrast the slide I just showed about how much we spent on health care, and how little we collected in revenues. That's a big part of our problem and what we need to focus on over the long haul.

This -- we have a collaboration with Demos and The Economic Policy Institute and we're going to release our blue print the Monday after Thanksgiving. And it will show that we can preserve existing Social Security benefits, allow for increased productivity-enhancing public investments, and bring long-term debt levels under control during the 2020s. Without going into great detail, some of the major changes for improving the budget picture include these three items, which add up to about a $3 trillion savings over 10 years, capping the benefit of itemized deductions at 15 percent, implementing the recommendations of the bipartisan Sustainable Defense Task Force, and taxing capital gains and dividends at the same rate as ordinary income.

That isn't all that much less than what the Bowles-Simpson plan had over a 10-year period, and theirs includes a lot of caps and attempts to reduce spending and raise revenues that are less specific than that. But we have a more elaborate plan but it can be done. The idea that we can't restore fiscal health without cutting social insurance benefits is a widespread belief and it's wrong. So we're going to prove that to you when we release our report.

And I'm going to stop there. Thanks very much. (Applause)

MR. HASKINS: You all come up. Now we come to, I hope, an interesting part of this program. Where we have four excellent panelists, all with longtime reputations in Washington for knowing a lot about government spending and government taxation and the budget. And all have taken a great interest for many years in the deficit. So we couldn't have a much better panel, I don't think.

And let me just introduce them briefly. Bob Greenstein, who's the head of Center of Budget and Policy Priorities and I would say a legend in Washington without question and around the country.

Gene Steuerle, longtime tax expert, former employee of the Treasury Department, and one of the original designers of Reagan One, I believe, the first Reagan tax reform proposal.

Then, Henry Aaron from Brookings, who has long been involved in budget issues and has written frequently. And I would say it's fair to call him somewhat of a critic of the plans that have been published so far, at least of the Bowles-Simpson plan.

And finally, Alison Fraser from The Heritage Foundation. Heritage has played a very active role, as has Brookings, and we've done a lot of work with Heritage and a lot of work with Alison. So we're very pleased to have Alison here today.

Each panelist is going to open with an eight-minute statement. Then I'm going to ask questions and it'll be your turn. Let's begin with Bob Greenstein.

MR. GREENSTEIN: Thanks, Ron, and Brookings, for holding the event.

I think I'm going to focus primarily on the Bowles-Simpson plan since it's so much in the news now. It's been getting a lot of positive media coverage for putting everything on the table and making a number of hard choices. I agree with those sentiments, and the praise for the plan's doing that. But that's not enough.

You have to get below the hood and also look at the specific choices that the plan makes. And when one does, I think one finds some elements are positive, some elements are disappointing, and some elements are deeply disappointing.

Basically, as a whole the plan does not, in my view, represent a balanced approach to bringing deficits under control, needs substantial changes, and ought not be approved without them.

Specifically, it starts to institute its deficit reduction 10-1/2 months from now, which I think is too soon for the fragile economy. It proposes policy steps that would impose some serious hardship on some of the nation’s most disadvantaged people, it relies far too much on budget cuts as opposed to revenue increases, both as a whole and in the Social Security part of the plan. In both cases, two-thirds or more benefit cuts or, for Social Security, budget cuts for the plan as a whole, one-third or less on the revenue side. And closely related to that, it has the misguided goals of calling for adopting policies that will hold annual revenues and spending, both to 21 percent of the gross domestic product in future decades, which is unrealistic given demographic changes, health care, and other things in which I think many mainstream budget experts -- you don’t have to be some flaming liberal to think that 21 percent can’t be achieved without pretty draconian changes.

It has some principles at the start. One of the principles is protect the truly disadvantaged. Sad to say, the specifics don’t comport with the principle. Now, it’s true that the plan avoids cuts in means-tested programs other than Medicaid, and laudably it increases Social Security benefits for many in the bottom quintile of Social Security beneficiaries.

However, just looking at the Social Security part of the plan, it has benefit cuts in the next to the bottom quintile and the middle quintile. Who is that? Well, SSA data show that the median income for elderly Social Security beneficiaries in the next to the bottom quintile -- including other income, including the spouse’s income -- was $14,000 a year in 2008. For the middle quintile, $20,000 a year.

In addition to benefit cuts, it has Medicare and Medigap co-payment increases for those people, which otherwise I might think would be quite reasonable. But you're extracting -- you're increasing the co-pays at the same time you're cutting benefits for people in the 15-, 20-, $25,000 range.

In an interesting piece Drew Altman, the president of the Kaiser Family Foundation, wrote: Warren Buffet is not the typical Medicare beneficiary. (Laughter) The prototype, Altman wrote, the prototype is an older women with multiple chronic illnesses living on an income of less than $25,000 who already spends more than 15 percent of her income on health care. It is the people on these programs and the realities of their lives that are being left out of the discussion.

When you get into other parts of the plan as well, looking at health care for a moment, the plan's proposed savings in Medicaid could make it difficult to ensure that there are enough Medicaid providers to serve the population, given that under health reform 16 million new people are coming on to Medicaid. It cuts the federal share of state Medicaid administrative costs just when states are asked to come up with the additional money to process the 16 million people.

It accelerates cuts in payments to hospitals that provide charity care to the uninsured without accelerating the health reform coverage expansions that make the charity care cuts possible in the first place. It has new rounds of cuts in payments to Medicare providers in the years ahead on top of those already in the Affordable Care Act, which could raise concerns about whether there are enough Medicare providers in that program.

Basically the problem here, I think, is one of -- sorry, I got my pages out of order -- is one of a lack of balance. Why do we have this problem with the plan? Well, I think the reason that the budget cuts overreach and have these concerns is the unbalanced nature of the plan overall.

If the co-chairs hadn't adopted the principle of holding federal outlays for decades to come to 21 percent of GDP, and it produced a plan that was more balanced, not one that took two-thirds of the deficit reduction from budget cuts and one-third or a little less, Isabel said, from revenue increases but was more balanced. Now, Rivlin-Domenici is 55 percent budget cuts and 45 percent revenue, to contrast the two. If you're closer to an even balance, then one is better able to avoid the most severe aspect of the plan that would cause the most damage.

If you take Social Security as an emblem of the larger problem -- so as I mentioned, under the Bowles-Simpson plan, Rivlin-Domenici is actually sadly similar in the Social Security area.[1] Two-thirds of the solvency improvements are benefit cuts, one-third revenues. That's in the first 75 years. By the 75th year, it's 80 percent benefit cuts, one-fifth revenues. Now, no past bipartisan Social Security plan has tilted that far. Traditionally, we talk about a 50-50 split when we've talked about bipartisan Social Security plans.

Bowles and Simpson have been praised as being brave in putting all these elements on the table. They are. They -- that praise, as far as it goes, is merited. But in my view, their plan is not brave on not coming clean on the degree to which we will need a better balance, we will need more revenue in the future.

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[1] Note: When the Social Security actuaries' analysis of the Rivlin-Domenici plan came out, it showed that the split between benefit cuts and revenue increases in the Social Security component of that plan actually is different from the split in Bowles-Simpson, with half or more of the Social Security savings in the Rivlin-Domenici plan coming on the revenue side.

And just think of the larger politics as well as substance. The plan doesn't say anything -- I know the political reasons why. But the plan doesn't say anything about the predominant issue now before Washington policymakers that has a big deficit impact. What to do about the tax cuts for people over $250,000 a year.

Now, I'd like anybody on the panel or in the room to explain to me how we can justify and how we could sell cutting benefits and raising co-payments for elderly widows at $20,000 a year while making permanent tax cuts that average over $100,000 a year for multimillionaires. I don't -- I mean, you want to talk about gridlock? That's a prescription to never get anything done.

And I want to close by coming back to this issue, which I do think is central to, is it really an appropriate target to say that revenues and expenditures should be held for decades to come to 21 percent of GDP, despite the aging of the population, and continued increases in health care costs, which even with the best cost containment, which we badly need, health care costs will continue to rise, hopefully at a slower rate, due to medical advances that improve health but add to costs.

The notion that limiting federal expenditures to 21 percent of GDP represents something of an extreme position that will require draconian cutbacks is pretty broadly shared. At an earlier meeting of a number of the same members of this panel and some people in the audience, a number -- excuse me -- a number of the panelists concurred that to meet the nation's needs 20 years or so from now, revenue will probably need to be in the 23 to 25 percent of GDP range. The Rivlin-Domenici plan has revenue, on average through 2040, at 23.1 percent of GDP.

And when an expert committee of the National Academy of Sciences issued a report earlier this year, co-chaired by Rudy Penner and John Palmer, they basically presented 4 paths to fiscal responsibility, 2 of which they -- 30 seconds -- 2 of which they described as extreme because they were almost all spending or almost all revenues, and they showed the draconian effects they would have. Their extreme path that was almost all spending cuts where they detailed the draconian results you'd ultimately get to? 21 percent of GDP, right where Bowles-Simpson is now.

Thank you. (Applause)

MR. HASKINS: Gene Steuerle. Unfortunately, Gene, you only have six minutes because Bob took so many.

MR. STEUERLE: I'd like to take a little bit different tact on this. I'm a supporter of almost any plan that gets at the long-term deficit simply because I think that's the big issue that faces us. And I actually don't care a tremendous extent whether we end up at 21 percent of GDP or 23 percent of GDP, or something like that in the future.

And let me give you just a simple set of numbers to tell you why. My calculations are that right now, federal government spends $30,000 a household. That is, take total spending of the federal government, divide it by the number of households. We're spending $30,000 a household. That's not means tested, that's just an average.

You add in tax expenditures, that's about $10,000 a household. That gets you to $40,000. Add in state and local spending, at about $10,000, we're at $50,000. So government right now is spending about $50,000 a household.

Project out some economic growth. Maybe it's only a couple percent for the next 30 years, and let's just assume government stays the same share of the economy. That $50,000 grows to $100,000. So, in the meantime, we're going to debate whether we want to be 21 or 23 percent of GDP. That's about a 10th. So, basically we're going to have this huge fight on whether government spending grows to $90,000 or $100,000 a household, depending on whether you're conservative or liberal. That's the fight we've had for ages, it's the fight we've had over the Bush tax cuts. As big as they are, they're about 1-1/2 percent of GDP. Long run, they're still small relative to whether we get this system in order.

And if we don't get this deficit under control, the interest cost on the debt is where we're going to be doing all the spending. And we're all going to lose.

And for those of you who are familiar with the classic academic prisoner's dilemma, that's the dilemma we're really in now. Is both political parties essentially want to control the future, and in some sense they're both right. If I don't control the future before you do, you're going to come in and you're going to get your tax cuts, you're going to get your spending increases, so I'm going to control the future before you do. And then that result has been that we now have a budget that -- and an economy -- that basically suffers from what I call a lack of fiscal democracy.

In fact, in 2009 and in perhaps 2010, 2011, it turns out that when Congress walks in the door, every dollar of revenue has already been committed. Now that's a neutral state between left and right because it comes about both because of low revenues, but it also comes about because of very high commitments for continual growth, particularly in health and retirement programs, that are scheduled under current design to grow forever faster than the economy. And for different reasons, but they are scheduled to grow at least as fast if not faster than the economy. And that just is not sustainable.

So I think we've got to get at this fiscal democracy issue. We've got to basically create slack in the budget, given the budget, so we can have these fights in the future so that as voters -- and I'm talking particularly to you young voters for whom we totally tried to deny you any opportunity to vote, whether we're on the left or the right. Because if we're on the left we're going to build all these growth into programs, and you've got to accept them because you're adolescents and we'll never give you the right to decide things yourself. And if you're on the right, we don't trust you because you're going to get all these tax cuts. And so we're going to try to build in tax increases that are permanent.

So, I think we have to restore fiscal democracy. And that's what I think the debate is about. And it's beyond the details of the particular programs. And I do fear something, and this is a criticism I still have of both plans except to the extent we really get these health costs under control through something like premium support, which I think would have support, to some extent, on both sides of the aisle. And that is, basically we have a budget that's oriented mainly towards consumption.

If you look at the budget for children -- and I've investigated this 40 ways of Sunday -- basically the budget for children continually gets crimped. Its share of the total budget goes down, the share of the budget that goes towards investment goes down, the share that goes towards consumption goes up.

Now, there may be reasons why its there. It may be because we have a health system we haven't gotten under control. It may be because we constantly sponsor more and more years in retirement. But whatever it is, it's a budget that supports us more and more to get more and more consumption, essentially to retire earlier and earlier on this benefit system. And we're crimping what we're spending on children and investment.

So that's why whether we go to $90,000 or $100,000 of spending in terms of the budget, I want to spend less on interest and I want to start spending a little less on consumption. I want to put a lot more into the investment category.

And I think actually what these commissions have done only gets us partway there. It only gets us partway there because it only basically tries to get this deficit under control if you accept my notion that it's the lack of fiscal democracy. It's this continual attempt to try to control the future that's our main problem, then the deficit is barely one symptom of that problem.

So we can treat the symptom, we can put the calamine lotion so the pain goes away, but having a deficit of even zero for all future years with the budget totally pre-committed leaves no slack in the budget.

Now, I want to make one other appeal, besides this fiscal democracy. I really want all of us, as we go to the future, to really think about applying principles when we debate these issues and not to debate them one at a time. And I think the previous two panelists both did this in different ways.

But I'm going to suggest that the fundamental political issue is that, in terms of applying principles, is that both political parties are afraid to ask the middle class to do anything. And Greg's plan, if you look at it a little bit, he only basically identified what was going to have to be paid for either by tax increases or spending cuts, essentially for at least the upper half, the upper third of the income distribution.

And I think the fundamental dilemma is that the middle class pays for most of government, and it gets most of government benefits. Both political parties are scared to death -- if you look through the rhetoric, you look through the last campaign -- they're scared to death to admit to the middle class that it might actually have to contribute something, either in the way of lower benefits -- lower benefit growth, I should say -- or in the way of higher taxes. And that fundamental dilemma has to be addressed.

And if we address it, then the next question is, well, how do we address it? And there I would argue we want to think about what principles do we apply? So let me jump to one of the areas where there's some contention. And that is an area like Social Security.

Yes, Social Security has only done so well in terms of providing benefits to reduce poverty. If you look at Greg's slide, in fact, he talked about success from the past. But his poverty slide, for instance, showed from about the early '90s on. We haven't reduced the poverty rate among the elderly. And yet we're spending hundreds of billions more in real dollars over that period of time, benefits have risen quite substantially. And yet, we haven't done much on poverty. Well, we could -- if we have progressivity as a principle, we could have a much more anti-poverty attack through Social Security.

And I would suggest -- and this is something that's bothered me for a long time. I would suggest that those on the liberal side of the aisle who spend so much time trying to protect Social Security from individual accounts -- they could argue politically that was right decision -- that they have totally missed an opportunity to build in much more protections for low-income elderly. That could have been a compromise, that still is a compromise that I think can easily be achieved.

I can tell you because I know people involved in making these compromises, I know the people on these commissions. And basically, they constantly say, well we're afraid to do too much to make Social Security too progressive. And it's the progressives that make this argument, it's not the conservatives. In this case, it's the progressives that say we're afraid to make this system more progressive.

I'm not arguing for means testing. I don't believe in means testing Social

Security. I am just talking about flattening the benefit a little bit to make it better protect the low-income poverty.

And also, to take on issues that people won't even put on the table, such as this system -- and I can give you reasons later on the side -- this system has an extraordinary discrimination against single heads of households. There's a technical reason for it, has to do with the design of spouse and survivor benefits that's free and you don't pay for it, and that they're geared towards higher income -- you could actually do something. We could get hundreds of billions of dollars shifted towards taking care of low-income -- particularly low-income women if people -- if liberals in particular would be willing to take on this issue.

So let's think about applying principles to addressing this issue. Let's admit to the public that the middle class is going to have to contribute something. And then let's figure out what's the best way? What's the best next -- of tax increases, spending cuts, whatever it is -- lower spending growth -- that the middle class can address these issues.

I suggest that we could get more anti-poverty protection. I suggest also for the middle class that one of the real tricks is to try to encourage them to work more rather than take benefit rate cuts. But we talked about that later.

Thank you. (Applause)

MR. HASKINS: Thank you, Gene. Henry Aaron?

MR. AARON: I was pleased that we did not go in alphabetical order.

This session was originally inspired by the papers that Belle Sawhill and Greg Anrig wrote, as Belle mentioned. Those addressed whether deficit reduction should center on cutting Social Security and Medicare as a means of balancing the budget.

Since then the Simpson-Bowles draft has come out and as of today so has the Rivlin-Domenici plan.

Everybody up here agrees that we have a daunting deficit problem and that it should be addressed soon. How soon, is not clear. The commission chairs, Bowles and Simpson, want to start deficit reduction in Fiscal 2012, that's September of next year -- October. Since unemployment, according to all projections, is likely to be in the vicinity of 9 percent and could well be higher, that starting point, I think, most of us here would agree, is too soon. But the starting point is not a minor issue because starting too soon could deepen the recession and there is no more effective device for blowing the deficit sky high than causing unemployment to remain at high levels.

But let's move from the date to the program. As noted, over the first 9 years the Simpson-Bowles plan achieves deficit reduction 70 percent through spending cuts and 30 percent from added taxes, and as Bob has stressed, the steady state spending level as a share of GDP is just 20.5 percent of GDP.

For comparison, that is lower than the actual spending level in the United States average from 1980 through 2008 when none of the Baby Boomers had yet retired and claimed Social Security or Medicare, and health care spending was a fraction of what it's going to be -- what it is today and will be in 2020.

Specifically the plan calls for a reduction in the growth of federal health care spending by 2040 by about one third, but it doesn't say how that target is to be achieved. The tax plans would curb or end deductions, among other things, for charitable contributions. That would curtail the capacity of the private sector to provide relief to the vulnerable populations in America at the very same time that the principle supports of these very populations -- Medicaid, Social Security, and Medicare -- would be cut.

The deductions for mortgage interest and property taxes would be curbed or eliminated, this during the most severe housing price collapse in at least 75 years.

Deductions for contributions to IRAs, KIOs plans, and 401(k) plans would be ended. Social Security benefits would eventually be cut by 25 percent for people earning $43,000, that's the mean, and by 40 percent for those earning $100,000. Note the double whammy: no Social Security and no tax sheltered savings plans. The plan actually contains some modest increases in Social Security benefits so that it increases the deficit from here to 2020.

The plan says it would fix Medicare fee cuts for doctors that are scheduled to take effect next month, but it doesn't say how. The plan would freeze salaries of federal employees for 3 years, cut the federal workforce by 10 percent, and dump 250,000 contract employees just when retirement of Baby Boomers and health reform implementation would be increasing administrative burdens of effected agencies.

To offset these cutbacks the plan calls for an increase in productivity of federal workers, but once again, it doesn't say how.

The plan would block grant Medicaid long-term care which would increase the marginal costs of that service to states by anywhere from 100 to 400 percent.

My reaction on reading this plan is mixed; the plan highlights a real problem and it's admirable that it does, but it is replete with magic asterisks. Most important, it sets spending and tax targets so low that sustaining even basic protections for the elderly, disabled, and poor, will be impossible.

There is a better way and some of the elements are in the Rivlin-Domenici plan. One, the first element should be a large and quite general tax on consumption, a value added tax. Some of the revenue from this tax should be used to lower the deficit, some should be used to compensate losers from base-broadening reforms in income taxes. That, and Gene can attest to this, was the recipe that made it possible to pass the Tax Reform Act of 1986. The Simpson-Bowles plan does just the opposite. It increases total income tax collections, which makes it impossible to compensate those who lose from ending specific deductions, credits, or exclusions.

The second element should be a vigorous implementation of health care reform. The various cost-reducing pilots and experiments in that bill are the only realistic way to slow the growth of health care spending without full-blown rationing.

The third element has to be a mix of some cuts in discretionary and mandatory spending, but relying on spending cuts starting next year for 70 percent of the deficit reduction to reach a spending level lower than the historic average means that the plan cannot honor its own stated principles including the promises not to disrupt the economic recovery, to protect the truly disadvantaged, and to promote economic growth.

On the subject of Social Security I want to make just a couple of final remarks. I would recommend to you the paper prepared by the National Academy of Social Insurance which lays out a plan for restoring balance but I would also like to pose a question: the Rivlin-Domenici plan contains a detailed Social Security program. It is part of an overall program to restore budget balance. How much of the reduction in deficits in the Rivlin-Domenici plan is attributable to the Social Security benefit cuts and other tax changes?

Over the next 8 years the answer is 3 percent. Over the next 30 years the answer is 6 percent. My point here is that dealing with Social Security in the framework of deficit reduction is a serious mistake. It has very little to do with the actual budget challenge that we face and the issues involved in Social Security reform are inherently quite technical, they involve conflicting principles, as Gene emphasized, they deserve separate study by a completely different organization so that we can move ahead with restoring balance in Social Security. Within the framework of deficit reduction is not the way to do it.

Thank you.

MR. HASKINS: Thank you, Henry. Alison Fraser?

MS. FRASER: Thank you very much. It's wonderful to be here. When I started framing my remarks we had a couple of commissions report, so what I had intended to say today has sort of been take over by -- overtaken by events, but I think, you know, all of the panelists have touched on various elements of the discussion today and I think it's a really, really important discussion that we're having as a nation. I want to especially thank Isabel and Greg for their contributions.

Like many of the deficit commissions, the paper that they put out that we were originally going to talk about, there are things from both presenters that I agree with and things that I disagree with, but the conversation that is happening today, both in Washington and across the nation, is one that I think is really vital and I welcome it and I would like to see more of this, not only here in DC, but part of a broader conversation that we have with the American public on what our fiscal policies are and what the nature of our fiscal crisis is. And I think you've heard some different viewpoints on what the fiscal crisis is.

Changes in the policy values that both Greg and Isabel, but indeed all of our presenters today have proposed and discussed, I think, deserve a thoughtful reflection by larger groups of Americans, and especially between the right and the left. I think this is one of the fundamental things that we as a nation need to get better at doing. We are in a very, very partisan environment right now. We certainly had a very partisan election, but as we look towards the future it's essential that all voices are heard and that we have a more thoughtful conversation about how to go forward.

Today we are financing too much of the federal government through borrowing. This is not sustainable and I'm exceedingly concerned about that. I do not personally hold the view that budget should always be balanced. I think there are times when running a deficit is acceptable. I think occasionally and rarely even a very large deficit level is acceptable, however, large and growing deficits in the future are not acceptable.

Deficits, I think, are largely a symptom rather than the problem in and of themselves, and they're a symptom that outlays and revenues are mismatched, and to solve the problem, we need to look carefully at what the root causes of it are.

So, there's a lot of talk about the future and a lot of talk about today. I just want to point out to everybody that in my look at the numbers, today's deficits are being driven by three things: markedly increased programmatic spending, interest on the debt, and a sharp decline in revenues or tax collections stemming from the great recession which, as you have heard, we are still not recovered from adequately.

So, I think any policy responses need to address today's deficits and all of the concerns that you've heard about underlying them, but they also need to begin to do so with an eye on future deficits and how they affect the extraordinary and worrisome level of debt that we are on a path to.

As I said, one or two years of extraordinary deficits is one thing, but a continued trend, such as that as we face in the future, and the impact that that has on our debt and interest payments, simply must be addressed.

When I look at the numbers what's driving future deficits are the entitlement or social insurance programs that we've been talking largely about in the panel today, and this spending cannot continue.  It is not sustainable, and it is seriously out of line with both our tax policy and our ability to tax or raise revenues without seriously damaging our economy.

I am one that believes that we must have a transformation of these entitlement programs.  I think that Bowles and Simpson did a little bit of this, but they didn't really transform them, they kind of budget-cut them, and I think one of the things that I was very pleased to see in the Rivlin-Domenici Commission Report, although none of us have had a chance to really go through it in detail, was them really taking a transformational look at what Medicare might be in the future, as both a way to deliver services more effectively in the health care market, but also to contain costs.

So, I'm also one who believes that these programs are vital to our nation's seniors, especially low income seniors, so the challenge in my view is, how do we go forward with unsustainable programs driven both by health care costs but also by demographics that are wildly popular and also have a myriad of inefficiencies and inequities in them?  I think this is a fundamental challenge.  We've heard lots of different concerns about them, many I agree with, but because we do have an urgency to address these unacceptable levels of debt driven by spending primarily, this means in my view rethinking some of these tenants of social insurance, and because we have limited resources, I think we need to think about targeting those benefits to the truly needy.  Who did we talk about earlier? Warren Buffet or Bill Gates or somebody? True, that's not the typical portrait of somebody receiving benefits, but let's have a conversation about whether those types of people should have benefits and how they should be delivered to them.

And the timekeeper is being merciless here. So I'm going to skip a bunch of stuff.

So, one of the things that's been talked about a little less is what tax policy ought to look like, so as the good conservative on the panel I'm going to talk about that. A lot of the conversation today revolves around tax expenditures, and one of the things that really bothers conservatives is simply the name "tax expenditures" and it's the notion that tax revenues somehow belong to the government as opposed to the taxpayers, our citizens who are earning their own income. This is a fundamental concern of conservatives and so in that vein, I do believe that we need to have a fundamental overhaul of our tax system including looking at those kinds of issues. I'll say tax expenditures even though conservatives hate that word. But I think it needs to be done less from a bookkeeping sense, which I think both Bowles-Simpson and the Rivlin-Domenici commission kind of went about it, but also more from a tax policy perspective.

One -- I'm just going to take one of the tax expenditures, and that is the health care exclusion. I think that this is -- you know, as you all know, it's one of the largest, but it's also one of the most pervasive and distorting tax policies that we have that also has a direct distortionary effect on our health care market. And there wasn't large discussion of either of the proposal -- the deficit proposals on just how transforming that one policy alone could be on our health care market. It could deliver better services and allow much more affordable and portable health care for all Americans, including middle class and lower income workers, and I think this would be a very, very fundamental important step that I would like to see.

So, am I out of time now? Oh, I hate that.

Let me just close with this thought and that is that I have been at -- I've done a lot of traveling around the country with Belle Sawhill and others who are in the audience today on the Fiscal Wake-up Tour, and one of the things that I'd like to share with you in my experience is that notion that when you present the facts to Americans, that all of them understand that we do need to change our fiscal policy, including older Americans, and that they understand that we need to do something to improve the outlook of our future, and I really welcome all of these conversations as to what we want the government to look like, how big we want it to be, and how high we want our taxes to be.

Thank you. (Applause)

MR. HASKINS: All right, panel. We have heard this morning and for the last couple years, in the case of some of us here, for almost a decade, that the path run is unsustainable. What does that mean? I want you to tell me, not a long story, but what's the worst-case scenario? I'm not asking you to predict it will happen, what could happen? What's the worst case? I would like you to scare the hell out of the audience.

Belle?

MS. SAWHILL: I didn't get my Halloween costume yet, Ron. What's the scariest thing that could happen? A financial crisis that makes the last one look like peanuts, and a federal government which is already in so much trouble fiscally that it has no way to respond to the crisis. And that's not a Halloween story, that's a real risk that we face as a country.

MR. HASKINS: Bob?

MR. GREENSTEIN: I don't have a lot to add to that. I think what it means is in both national and international economic terms, ultimately you just can't keep going in that direction. Ultimately the debt gets so large as a share of the GDP, and interest payments so large as a share of the budget, that, in fact the fact that it's unsustainable, it's sort of that old statement of if something can't continue forever, it won't. Which leads one -- if you think it's unsustainable, it also leads you to the conclusion that sooner or later major policy changes are coming, but it isn't clear when and it isn't clear what they'll be, and there's also an argument that if you wait until a crisis to make the changes, the changes that are made in the middle of a crisis may be more ill-advised changes.

MR. HASKINS: Gene?

MR. STEUERLE: Well, I mean, in addition to the obvious economic threat of things just sort of blowing up, there's just the fact that we're already squeezing fundamental functions of government, including, as I mentioned, spending on children and investment in our economy and infrastructure, a lot of other things, that's already getting squeezed as interest rates absorb more and more of the national economy. We're spending more and more of our income to pay bond holders abroad and other places, and so the net result for liberals is they get fewer of the programs they want, and for conservatives, they get the higher tax rates.

MR. HASKINS: Henry?

MR. AARON: Greece.

MS. FRASER: France.

MR. HASKINS: Great. All right, next question. Almost everybody addresses in way or another, can we run the federal government on 21 percent of GDP?

SPEAKER: What's your timeframe for the question?

MR. HASKINS: Divide it up as you will. Say in the short run yes, but in the long run, no. Something like that.

MS. SAWHILL: You want us to go in the same order?

MR. HASKINS: Sure.

MS. SAWHILL: No, I think it's too low. I don't think it's realistic. I was at a small dinner last night with some members of Congress and Simpson and Bowles and we talked about it and their argument is, this has been the historical level, roughly speaking, and, therefore, it's not in our -- it's not going to be acceptable to the American public to go much above that. Some of us countered with the idea that because of the aging of the population and rising health care costs, the historical level is no longer very realistic, but they really maintain that it is, that it can be done, and that the public wants to keep revenues low and government relatively limited.

MR. GREENSTEIN: I think the argument that because this was the historical average it's the appropriate level, is -- I'll try -- it's a really ridiculous argument. It would be a very reasonable argument if the age of the population in the next several decades would be the same as the average age over the last several decades, if health care costs in coming decades would be what they were several decades ago, if the terrorist attacks of 9-11 had never occurred and we were back at the homeland security spending levels which were tiny that preceded 2001, if the Medicare prescription drug benefit hadn't passed -- I'll stop there; I could add more to the list.

When the National Academy of Sciences constructed its illustrative path that had 21 percent of GDP, what it did to get there was deep cuts in Social Security, Medicare and Medicaid, plus a 20 percent cut for all of the rest of the government including defense, education, infrastructure, veterans, medical research, and the like. Now, you know, the public has accepted in previous decades, recent decades, the 21 percent, but if you went back 50 years or 80 years or 100 years, you would have a lower level.

Times change. I'm not saying there's no limit at all, but the idea that the U.S. of the future is the same as the past 30 or 40 years ago is like saying 2 + 2 = 117.

MR. HASKINS: Everybody does not need to answer this question. Does anybody else want to say something about it? Greg.

MR. ANRIG: Yeah, getting back to Gene's point earlier about his concerns about binding future generations to the decisions that people made in the past, the idea that any Congress in current time or in the near future should set some sort of future benchmark that shall be everlasting and determinative as to how much the government should be spending is absurd. Future Congresses, future Presidencies, ought to be able to make the decisions at whatever point in time they're operating in, whether there's a time of war, whether there's more recessions, whether there's prosperity, to be able to make judgments and then whatever the heck spending levels turn out from that, that's what it will be based on their own decisions and the political process.

But I think it's a crazy idea to come up with lids that will bind future generations.

MR. HASKINS: Gene?

MR. STEUERLE: You know, on many of these issues I think the members of the panel are probably in agreement. I would say probably if we were designing a deficit reduction package, there's probably 70 or 80 percent of the items we'd agree upon. In fact, a real debate, I think would be one like between Faulkner and Hemingway, you know, when Faulkner said to Hemingway that he never used a word that would send somebody to the dictionary, and Hemingway responded, well, poor Faulkner, he thinks big words mean big emotions.

But in terms of could we live with 21 percent, the answer is yes. We've done it in the past, we could do it in the future. In my numbers, can that $50,000 of spending, does that have to go to $100,000 as opposed to $85,000? That's sort of the question you're asking over several decades, but the bigger issue which is related to the responses that Bob would give, and I'm sure Henry would note, is that you only get there if you're really going to tackle the issue of health care and you think you can do it because that's the big 800-pound gorilla, and so we have to figure out, if we don't get those health costs under control, then, no, we can't do it at 21 percent. And I would add to this, not at the same level, but certainly is important, is do we keep demographics on a trend -- we now retire people for about a third of their adult lives, and that number would increase -- it would actually even increase or stay the same under the various plans that have been offered so far, and that's a pretty expensive item to maintain as well, so if you don't tackle the demographic issue, and particularly you don't tackle the health cost issue, then, no, you can't do it at 21 percent.

SPEAKER: One quick clarifying point. I think -- I find these revenue and expenditure distinctions in caps really injurious to having an intelligent debate. Here's an example. Allison mentioned the co chairs plan proposes -- and I think there's something like -- I think Rivlin-Domenici goes even farther -- in either greatly limiting or over time eliminating the employer health exclusion.

Now, if you squeeze down or eliminate the employer health exclusion, under health reform, more people will go into the new health insurance exchanges, so instead of getting a tax exclusion and coverage through their employer, they'll get higher wages that are taxed and they'll get a subsidy, if they're below four times the poverty line, to help them buy coverage in the exchange. It may be a better policy, it may be a worse policy. The point is, total federal revenues go up because you have a smaller employer tax exclusion. Total federal outlays go up because you've replaced the tax exclusion with a direct subsidy. The government is in the middle of it in providing a subsidy both ways, but under one way, both spending and revenue are lower as a share of GDP, under the other, they're higher. It's a perfect illustration of why these artificial targets inhibit good policy debate.

MR. HASKINS: Anybody else? Okay, Gene and Alison, we just listened to liberals complaining -- or, progressives, sorry -- about --

SPEAKER: You can call me liberal, I'll take it.

SPEAKER: Me, too.

MR. HASKINS: See, we've got real liberals here. I never had any doubt about you, Greg. So, they are complaining because most of the cuts -- most of the changes are in spending cuts, as opposed to tax increases, and in Social Security, I think according to Bob's document, maybe I read this wrong, but I think eventually it gets to 80 percent --

MR. GREENSTEIN: Eighty-three.

MR. HASKINS: Eighty-three, ultimately, benefit cuts. Why aren't Republicans celebrating? Why don't they embrace this thing and say, it's a deal?

MS. FRASER: Well, I can only speak from sort of the conversation around my building and, you know, conservatives worry about having a strong defense and they have massive cuts in defense in the view of many conservatives, far lower spending than, you know, the president and the congressional quadrennial defense reviews say are necessary for us to protect ourselves. And we are in a time of war and it's not foreseen that we're going to end that type of war any time soon. That's one reason. And, you know, to be very blunt, conservatives are very upset because they see a massive tax increase, so you see taxes going from this historical average, and we can debate whether that's the right number or not, to, you know, 21 percent under the chairman's proposal, and I don't know what it under the Domenici-Rivlin -- 23, so even more. And they don't like to see big tax increases.

So, you know, from the perspective of conservatives, writ large, they're viewing this as a spending problem and they want to see much more emphasis on spending.

MR. HASKINS: Gene?

MR. STEUERLE: Well, first, I guess I've never really accepted labels one way or the other. I don't like the liberal label and I don't like the conservative label and I think that both of them are --

MR. HASKINS: You're a conservative, Gene.

MR. STEUERLE: No, I think they actually -- well, actually, I believe in progressive but lean government. And I've always fought those members on the right who say they don't believe in progressivity. I think that, in fact, it's almost part of the natural law. If you think that your kids should contribute equal amounts to the well-being of the family when they're 12 or 13, then maybe you don't believe in progressivity. You think that people with greater ability to work should pay more and contribute more to the family, you're progressive, and then the question is, just how far do you go along those lines, whether you're raising a family or you're in government?

So, I very much believe in progressivity. You've heard a lot of the arguments I've made is I want to get more money in for children, this is where Belle and I have worked for a long time together trying to worry about that issue, trying to get more money in investment, because we think that promotes growth and actually helps people long run. I do think there are limits on how high tax rates can go, so I accept efficiency as a principle as well.

But let me follow Bob's argument on -- let's not just define things as spending versus taxes --

MR. HASKINS: Wait, before you do that, why aren't Republicans embracing this?

MR. STEUERLE: I think right now there are two issues. One, if you look carefully at the analysts on the right, they have actually, for the most part, been less rejective, if you want to, than I think some people on the liberal side. Why the right hasn't embraced it is because in part right now they're scared to death to admit that they would accept any tax increase, including tax expenditures, on anybody at any time anywhere because of this political constraint within the party, even though, in the past, they've long been on board. And I worked with, you know, the Reagan Administration, the Carter Administration on this as well, on going after tax expenditures, and I think that's the political trap they're in. That trap's related to the one I mentioned earlier, that both political parties -- I'm talking about at the political level, not at the analytic level -- are scared to death to tell the middle class they've got to contribute to solving this problem. And on the right, it's telling them they have to contribute in any way, and losing any tax benefits or paying a higher tax rate.

MR. HASKINS: Belle, then Alison.

MS. SAWHILL: So, just to elaborate on this, I mean, it's a matter of ideology within the Republican Party right now not to support any increase in revenues. But as I think Gene indicated, there are certainly people outside of the political system who have reputations as very good, smart conservatives, who have come out in favor of this plan. I think of Glen Hubbard, who was chair of the Council of Economic Advisors in the, what, Bush Administration, and is now dean of the business school, I think, at Columbia, had a piece in yesterday's *New York Times* in which he pointed out that the Bowles-Simpson plan does reduce tax rates enormously. They go from the current structure to just three rates, 8 percent for the lowest income groups, 14 percent for the middle, 23 percent at the very top, and they reduce the corporate income rate to 35, to, I think, 26, if I remember right. Most conservative economists would basically celebrate that because that makes the economy much more efficient. What they care about is marginal tax rates and their effects on saving, investment, innovation, work, and so that's a great trade off.

The problem with those who are in elected positions is that many of them signed pledges saying they would never raise revenues at all and it's just a particular ideological position they've taken, it's part of the problem we face right now, because as long as Republicans, elected Republicans, refuse to contemplate any increase in revenues, then Democrats are not going to compromise on what's dear to their hearts, which is Social Security and Medicare. And we're going to have stalemate, and the economy is going to suffer, and standards of living are going to be lower than they otherwise would have been in this country, and everybody is going to be worse off, in my view.

MR. HASKINS: Alison, and Bob, and please be as brief as you can so we can go to the audience.

MS. FRASER: Yeah, I think it is a little bit of a game of chicken here. You know, Republicans are very distrustful and conservatives -- those are two different -- not necessarily the same thing, right -- they're distrustful of having revenue increases happen without the accompanying tax cuts -- excuse me, spending cuts. And they feel like they've been burned in the past, and so they are very, very reluctant to even have a conversation about this, so this is sort of the nature of the spending cut -- or the tax cut pledge that they've taken. And, you know, that's one of the reasons that, you know, Nancy Pelosi thoroughly trounced the tariff's position. She doesn't want to talk about any cuts, Republicans don't want to talk about any taxes going up in any way, shape, or form, though Belle is absolutely right, there's a number of really wonderful tax reform elements that Bowles and Simpson propose in their plan.

So, it really is sort of a game of chicken between the two sides. My concern is, how do we move forward beyond that?

MR. HASKINS: Bob?

MR. GREENSTEIN: Alison, in her first comment, referred to the plan as having, I forget if the word was huge or massive, tax increase. We have a baseline question here. So, if you assume that all the Bush tax cuts are made permanent, compared to that, you do have a tax increase. But if you use what's called the current law baseline, under which those tax cuts expire, you find that under the Bowles-Simpson plan, taxes are actually lower than under the current law baseline. They basically would be restored to about the level they were as a share of GDP at the end of the Clinton

Administration and we all remember how terrible the economy was in the late ’90s.

MR. HASKINS: That was sarcastic, Bob.

MR. GREENSTEIN: One quick point, which is very distressing in my view. What I’m told is going on within the commission in the last couple of days is the Democrats, in predictable form, probably have about as many positions are there are democratic members on the commission. I don’t know as much about the Senate Republicans. The House Republican congressional members, I’m told, are operating as a unit, and they are basically threatening to vote no unless a significant share of those -- not that huge, in my view -- revenue increases already in the co chair’s plan, are removed, and the domestic spending cuts, already very large in the co chair’s plan, are made much, much deeper. And that’s where we are at the present time.

MR. HASKINS: Audience, raise your hand, tell us your name, ask a quick question.

In the back. The gentleman whose hair looks like mine, I didn’t say it was gray.

MR. O’CONNELL: My name is Brendon O’Connell. I’m with the Florida Bar. The one thing that I don’t see from the panel is what David Cameron says, we’re all in this together. Every age group in the country -- I’ll just give you a quick example. They have paid me back my Social Security twice. Last year I paid $10,000 in federal taxes. They paid me $25,000 more in Social Security benefits, so I can afford this, even if it’s only 3 percent in the reduction, let’s do it.

SPEAKER: You know, the main issue on Social Security that’s raised -- that was raised by Gene certainly too is this concern about, we’re paying people who don’t need the money, that they’ve already, you know, established themselves as being very comfortable in their old age, why are we spending so much money on those people, they don't need it. You know, if you look at the demographics, there's maybe about a fifth of the elderly population who are comfortably secure enough where you could say, safely, they not only don't need it now, but they're unlikely to need it if something goes wrong in the future for them.

The whole challenge with the system, though, is these people have paid a lot of money into the system, the system works largely because everybody's in it. It's self-sustaining, that's what makes it popular, and the more you cut benefits, the greater risk you put to the entire system, and that said, the replacement rates are already quite low for older people who have earned a lot in the past, they're going to be getting lower still. The Medicare Part B premium is indexed in a way where people who are very wealthy pay a lot more on that, and that's subtracted from your Social Security.

So, you know, there isn't this huge amount of money to be gained there by slightly reducing the benefits for people in that category. You can pick up some, but it's not really going to begin to address the shortfall in a meaningful way.

MR. STEUERLE: Can I clarify? I actually said I don't believe in means testing Social Security. What I do believe is that given the balance we have, we have to ask every client -- we do -- as the gentleman here said, we have to ask everybody what modest contribution they'd make, and I think at the top we can flatten the benefit a little.

My big issue that I have with the middle class is I don't want to cut back on the annual benefit. I do worry that at the early retirement age, the earliest retirement age, which started off giving people an average 14 years of benefits today, by the time you get to 2080 our projects are they'll have about 26 years of benefits, and I think that is a real threat in the middle class to their well being. What I would ask of the middle class, mainly, is not a lower annual benefit, but I would ask them to actually start working a little bit more because I think 26 years of benefits for the average retiree, and over three decades for the average couple, which is where we're going, is just too long of a period to be providing benefits efficiently relative to other needs in society, and also relative to their needs in old age versus young age. So, that's where I would go with them. I don't --

MR. HASKINS: Bob?

MR. STEUERLE: I don't propose mean testing.

MR. GREENSTEIN: I don't want there to be -- I hope there isn't, but I don't want there to be any confusion. For someone like myself, saying that the Social Security benefit cuts are too deep and go too far in the Bowles-Simpson plan is not the equivalent of saying there can't be any benefit changes at all. I don't believe that there's a problem in a plan that has some benefit changes, but they need to be relatively modest, the balance with revenues needs to be appropriate, people like that elderly widow with chronic conditions at 20-, $25,000 a year needs to be protected, in my view, the Bowles-Simpson plan, and Rivlin-Domenici as well, go too far on the benefit cuts in the Social Security side, as I mentioned earlier.

In the past, we used to talk about 50-50 splits when we talked about balanced Social Security Plans, and I think there's a legitimate question about whether you could even safely get as much as 50 percent now from benefits for a couple of reasons, you know, one of which being the benefit changes that were already made in the '83 law, but the bigger one probably being something that we don't talk about that much, I think Henry mentioned it, which is your Social Security check is not the same thing as your Social Security benefit. Your check is your benefit minus the Medicare premiums that are deducted from it, and the Medicare premiums are rising significantly faster than the Social Security checks are going up because they go up with health care costs, not general inflation. So, when you want to look at where you're taking benefits down the road, you have to factor in that a portion of the benefits' purchasing power is already going to be eroded over the coming decades by rising health care costs, which is also one more reason to get health care costs under control.

MR. HASKINS: Henry?

MS. SAWHILL: You know, I have -- okay.

MR. HASKINS: Go ahead, Henry.

MR. AARON: I just wanted to explain why I think broad-brush simplistic statistics are very misleading here. The proposals, in one way or another, the Fiscal Commission Proposals, call for across-the-board benefit cuts based on the fact that longevity is increasing. Longevity is increasing, but it's not increasing proportionately for everybody. It's increasing much more for those who have relatively high incomes where longevity has gone up a whole lot, and it's gone up relatively little for people with low incomes. So, you have an average increase in longevity, which leads to an across-the-board benefit cut, which falls -- reminds one of the old French law with complete impartiality, for bad, rich, and poor alike from sleeping under bridges, in this case, you have an across-the-board benefit cut that falls with complete impartiality on those who really are living longer, and those who aren't. That's why I think the relatively simplistic approach that these commissions have taken to Social Security, is ill-advised.

The provisions relating to Social Security make a very small contribution to dealing with the problem, we all agree really needs to be faced up to, which is controlling the budget deficit. Social Security proposals are intensely controversial on both the right and the left. We would be better off if they were removed from the debate about deficit reduction and they were given to a group, perhaps appointed by the President in a way similar to this one, that would deal with specifically how to reformulate the Social Security benefits to achieve many of Gene's objectives with which I wholly concur, and that meet the constraints that Bob has described.

But these relatively crude, kind of meat-axey approaches, that are in these proposals, it seems to me, do not serve Social Security well, and they don't make a significant contribution to dealing with the deficit problem. Indeed, they may well hinder the achievement of an agreement on the subject.

MR. HASKINS: Belle, be as brief as possible because we've got to get at least one more audience question.

MS. SAWHILL: Well, I fundamentally disagree with Henry and Bob and probably with Greg, as well, on this issue of Social Security. I think they are far too critical of what these commissions have suggested. The commissions both make it very clear that they want these changes phased in very slowly. The increase in the retirement age in Bowles-Simpson doesn't -- isn't going to affect anybody in this room, and it isn't going to affect even my grandson who is now 18. It might affect someone who's born this year.

And some of the changes will begin to be phased in a little sooner than that, I realize that, but there's been a huge amount of press about the increase in the retirement age to 69, and the early retirement age to 64, and a lot of the critics have implied that these changes are going to happen very quickly. The phase-in rate is not entirely clear to me. Maybe it is to you, Henry; I haven't seen the details. I'm happy to be corrected if when the details come out, the phase-in is much more rapid than I think it is, but I don't believe it is. Let's remember that because of economic growth, assuming we have economic growth, and economic growth is somewhat at risk because of these deficits, everybody will be a lot better off by the time these changes are made than they are now.

The average or typical retiree right now has an income of $43,000 a year, add a 2 percent growth rate over a 40-year period, that same family will have an income of $95,000 a year. And now, you know, everybody's -- that's in real --

SPEAKER: (inaudible)

MS. SAWHILL: No, no. And that's a real figure. I mean, I could get out my --

SPEAKER: I don't think that's right either.

MS. SAWHILL: Well, we could go into lots of debates up here about numbers and I'm happy to have a side debate with you about the numbers, but I just want to say for the record that I strongly disagree with the criticism of both of these commissions on the Social Security front.

MR. HASKINS: Question from the audience, right here.

MR. BENJAMIN: Matt Benjamin, Medley Global Advisors. So, the dramatic divisions between Republicans and Democrats on this issue makes it seem to me at least that a compromise is very far off. In Europe we're seeing austerity measures by many countries pushed there by bond markets, really. In the U.S., by contrast, Treasury yields are at near record lows, the dollar is, if anything, more secure as a global reserve currency because of doubts about the euro. Do we have to approach a Greece or an Irish situation before we can make real progress on this?

MR. HASKINS: I don't think that's a question, but I bet a lot of people on the panel agree with it.

One more question.

MR. BENJAMIN: No, it was a question. I'm saying --

MR. HASKINS: No, I got it. It's good. It's a good point. Oh, it is a question.

MR. BENJAMIN: Yeah, do the panelists agree with that? Do we have to get to that point?

MR. HASKINS: So, the question is, do we become Greece before we do anything? The answer is yes, by the way.

MS. FRASER: I certainly hope that we don't have to get to that kind of situation. I think that this is -- I certainly hope that we don't have to get there because I think when you get there then you have to make very Machiavellian and extreme policy reactions that are going to hurt everybody and they're going to harm our ability to grow the economy and keep strong. But I do worry that you have so much fighting about what all the details of these fundamental overhauls are that you don't get action, and that's why I said in my comments, I welcome a lot of these conversations. I'm probably -- am I the only conservative on the panel? -- you don't know what you are. But, you know, we need to have these conversations about what we want government to do so that we can get our act together before we have any kind of crisis like that.

MR. HASKINS: The lady standing up, right there next to you. Okay, ask a quick question, please.

DR. POPMAN: Yes, my name is Dr. Caroline Popman. I wanted to ask if the commissions had factored in the reduction in aggregate demand that will come when we reduce payments for Social Security and Medicaid, and transfer health care costs from Medicare, the government, to ordinary people. My father died five years ago, my mother, my sister, and I would have been bankrupted by the cost of his care.

MR. HASKINS: Gene, you're closest to the microphone, therefore, you have to answer.

MR. STEUERLE: I think the question of aggregate demand is -- aggregate demand is more a question of what's total -- where do you want to be, and we might differ on how much stimulus we want to provide over time, what's the total level of demand you think is provided by government in terms of spending. At full employment, we don't think government spending adds to the demand, when there's less than full employment, we think it does. But it's less affected by the particulars of the programs.

I want to make one very minor technical point, and it'll be very quick. What the actual -- the President's Commission does on the retirement age is it actually increases the number of years of retirement support you get because what it does is it keeps relatively constant your years of retirement relative to your years of benefits. And I think, in my view, I think that's inadequate. And on the Domenici-Rivlin one, they're not going to do much on the retirement age at all in both cases because the labor unions pretty much took a strong stand there. In my view, this inability to work on this crucial issue of getting people to work longer reduces revenues overall for the government, reduces the progressivity of the system, reduces what we can support, but technically that's -- neither one of them really do much on the retirement age.

MR. HASKINS: Please join me in thanking the panel.

(Applause)

And let me say to the audience a couple things. First of all, I'm sorry we have to end so early, but we had to change the time of this event because of the Domenici-Rivlin Commission and we have to get out of this room right away, so if you want to talk to each other, that's great, but please do it out in the hallway.

We will be having more events, I look forward to seeing you in the future. Good day.

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