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ON GROWTH THROUGH INNOVATION

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PANEL 4: THE PROMISE OF A MORE EFFICIENT AND EFFECTIVE GOVERNMENT:

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Governor
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THE HONORABLE EVAN BAYH (D-IN)
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PROCEEDINGS

MR. ANTHOLIS: Welcome back. I hope everyone had a good lunch. We're going to pivot now. We've been talking about innovation in the private sector to innovation in the public sector. From Greece to Germantown, Pennsylvania, local, state, and national governments are all facing budget crises, and, without question, this is the greatest thing that's driving innovation in politics. Yet, as we heard on the first three panels, we're also facing infrastructure and other investment deficits that are holding us back from competing internationally as a country.

So the question for all of our panelists, really, is how to do these two twin challenges at the same time: get our fiscal house back in

order while not underinvesting in the things that make us competitive?

And we're going to start today -- I'll introduce the panelists in a second -- but we're going to start I think with a question that is less known well in Washington, which is the crises facing states and localities. States have to balance their budgets, yet state after state face significant shortfalls. Pennsylvania, which is represented today, faces roughly a 4- or \$5 billion shortfall -- I'll have the governor explain that to us in a second; New York, roughly 9; Texas, 14; and California at least \$18 billion and perhaps upward to \$25 billion. These are enormous challenges.

States' revenues in particular are sensitive to economic fluctuations and in particular the rise in entitlement costs and public pension costs plus Medicare and Medicaid, and because states can't run deficits it often forces pragmatism over political polarization. So at the national level the things that states have to do on an annual basis we've been able to roll into longer-term deficits. And the question is whether or not those are sustainable and will force a meeting of the minds in a very polarized Washington.

So to address all of these issues we've assembled a really terrific panel that I'm delighted to have, starting with Governor Edward Rendell, who for the last eight years and until next Tuesday, has been and will be the governor of Pennsylvania. That's 2,913 days down and 5 or 6

to go.

GOVERNOR RENDELL: By this count.

MR. ANTHOLIS: By this count. We do data here.

Alice Rivlin to my right, who has held the two top jobs in the federal government at either end of Pennsylvania Avenue, a lot of addressing budget issues: the Congressional Budget Office and the director of the Office of Management and Budget. Less well known, perhaps outside of this building is that she's been a senior fellow here at Brookings off and on for four decades, and she's been a member recently of both the President's Commission on Fiscal Responsibility and Reform and co-chair of the Bipartisan Policies Debt Reduction Task Force with Senator Pete Domenici.

To her right is Senator Evan Bayh, who for the last 12 years has been the senator from Indiana until just last week, and before that was a governor for 8 years. And it's hard to imagine, just as it's hard to imagine looking at Alice that she's been here for four decades, it's hard to imagine that he's been in public office for that long. But he started pretty shortly after he graduated from the University of Virginia's law school, in which I take particular pride.

MR. BAYH: I thought you were going to say high school, Bill.

MR. ANTHOLIS: Yeah. (Laughter) To his right, literally and figuratively, is Ron Haskins, who is another senior fellow at Brookings who served on the majority House Ways and Means Committee staff during the years when Newt Gingrich was Speaker of the House and when Speaker Gingrich and President Clinton were able to work together on a number of different issues, including welfare reform which Ron was instrumental in. Ron is also -- was a senior advisor to President George W. Bush on welfare policy and other things. He's written quite a lot about deficit reduction and government reform and efficiency.

And then finally, to the far right Ann Brookings -- Ann Fudge, who is a Brookings trustee, which means unlike everybody else on this panel, technically at some level she's my boss. And that's a good thing, Ann having run terrific outfits like Kraft Foods and Young & Rubicam brands. And Ann also served on the President's Deficit Commission.

So with that, starting with Governor Rendell, you've been not just a governor, but also a mayor and a national party chairman. Connecting the federal to the local in the 2009 stimulus package went a long way to helping distressed states and localities deal with the immediate budget shortfall from the financial crisis. But that money's not coming back, at least not in the enormous amounts that came in those first

two years.

How do state and local leaders do this? How do they address both the budget deficit but also the investment deficits that they're facing?

GOVERNOR RENDELL: Well, let me answer that by going back a little bit in time to when I first became governor. In the first six years that I was governor we had good times, good growth, growth averaging around 5 percent. Every percent of growth for Pennsylvania is an additional \$260 million of revenue, and I took that additional revenue at savings that we were able to effectuate in the cost of the operation of the government, and I spent it.

I don't apologize for spending it. I believe government should spend money on worthwhile things like the physical infrastructure or intellectual infrastructure, protecting our most vulnerable citizens. I spent it and Pennsylvania is by far the better for that spending. How did we save that money? Well, we took out, and once the recession that we continued this, but we started taking out things from the cost of the operation of the government. Today we spend almost \$2 billion a year less on the operation of the government, the overhead of the Pennsylvania government, than we did in 2002.

In terms of raw numbers, not adjusted for inflation, our GGO

-- General Government Operations -- is less than it was in 2002. We did it because we applied the same things that we did in Philadelphia: We looked at every government program and said eliminate it if it's not good; if -- even eliminate it if it's good but it's not reaching the mark. Find a way to do it better.

Let me just give you two quick examples, and then I'll go to the "what's next" concept. We sourced our purchasing. Believe it or not, when I became governor, Pennsylvania had 800 separate contracts for office supplies. By sourcing that and bidding it out to one company, just in that alone, we saved \$11 million. Eleven million dollars a year overall by leveraging purchasing, and Pennsylvania purchased over \$3 billion, a little under \$4 billion of goods and services. By sourcing our purchasing, we saved over \$300 million a year on an annualized basis.

There's a Center for American Progress Study that said if the federal government did the same thing, it could save \$40 billion a year. And given what the federal government invests in purchases and spends, that's probably not far off the mark. Common sense things.

We had six computer contracts. We sourced them, bid them out, Dell won. We saved \$17 million on computers for the work force for the 78,000 workers we have in the state of Pennsylvania.

Second -- and these are things that are obvious as on your

nose, but nobody ever did them -- we have gotten significant dollars for weatherization, our own dollars and, of course, lately uptake in federal dollars and then with stimulus a huge uptake in federal dollars. But we never connected those weatherization dollars to our LIHEAP participants. People would apply for LIHEAP assistance, and we'd give it to them, and we'd have a weatherization program and never the twain should meet.

Well, somebody decided let's start weatherizing the people who are asking for LIHEAP, and guess what happened: Our LIHEAP requests went significantly down, and we saved significant money because we weatherized those houses. By weatherizing them, they didn't need to use as much fuel. Common sense stuff. I could keep you here for the next hour talking about other examples, but I won't.

Let me shift now to post-recession. Post-recession. In the midst of the recession every state has made budget cuts. In Pennsylvania, we've cut \$3-1/2 billion out of our budget in the last 2 years. The new governor is going to have to make further budget cuts. But I believe by making those budget cuts in the right way, by increased revenue, and that's happening all over. Governor Christie and his State of the State Address yesterday said the same thing is happening in Pennsylvania return of revenue growth. We had last month, our revenue came at \$175 million above estimate.

We're thinking that we may have 4 percent revenue growth in the next fiscal year beginning July 1st to June 30th. With that increased revenue, with increased savings, with making these cuts, continuing to find new ways to do it -- and there are always new ways to do it -- you borrow from everybody in the world. If another state's doing something that would save money in another ADA program, I want to know about it. By doing that I think we can get through this crisis.

Pennsylvania loses \$2.6 billion in stimulus; it loses about another billion dollars in increase in mandated costs -- that's Medicaid corrections -- and almost \$500 million a year in increased pension costs for our teachers and our state workers. So those are our two big drivers. If -- with renewed growth, with judicial savings, we'll be able to get through I think the next year or maybe the next two.

The type of spending that I did even in the teeth of the recession, I increased education funding significantly. I think we were the only state in the Union to do that, but we needed to do that, and we have made great progress in education. That's probably going to grind to a halt or be put on hold for the next tow years as we lose the federal money.

But we can get through this if we put increased spending on a hold, and, hopefully, when two years pass, if the economy is robust enough and growth continues, we can get back to investing in things that

we need to invest in.

The last thing, physical infrastructure. The way we've invested in it, in Pennsylvania, is I have pumped up the capital budget. Even in these difficult times states can use capital budgets to continue to invest in their physical infrastructure to make it better and to create significant jobs and significant contracts for both construction companies and manufacturing companies. I urge all new governors or existing governors to look at their capital budgets as a way to do it.

And, frankly -- last thought -- frankly, it is long overdue for the federal government to have a capital budget. There's no reason for us to pay for bridges, let's say, which has a 40-year lifespan the same way we pay for paperclips that have a 40-day lifespan.

MR. ANTHOLIS: Alice, you've been on commission after commission. I was surprised to hear that you found that to be an energizing, an energy additive experience rather than one that sucked energy out of you. Tell us about that. What is making you think that this might actually be a fixable mess?

MS. RIVLIN: If it's not a fixable mess, we're in deep trouble. We have to fix it. And unlike the governor's experience, which is optimistic in the sense that he is saying maybe the economy has turned the corner and our revenues will start up and things will get better, the states are in

trouble because of the recession and the deep financial crisis that precipitated it.

That is, unfortunately, not true of the federal government. The crisis facing the federal government, and it is a serious threat, is not the crisis of a recession, although the recession and the things that we had to do, like aiding the state of Pennsylvania to get out of it, increased the debt. But the problem that the United States Government at the federal level is facing is that we are on a track that is unsustainable, not because of the recession but because of things we have done policy-wise over a great many years combined with the fact that we have an aging population and a very rapidly rising cost of medical care, and taste for good medical care. We want it. We all want it, and older people consume more of it.

So this is a story that everybody's familiar with because it's been true for a long time. But as you project the federal budget, even as the economy recovers, what you see is federal spending will grow faster than the economy can grow and revenues won't. Revenues will grow at any set of tax rates about as fast as the economy grows, but the three big entitlement programs driving federal spending over the next few years --- Medicare, Medicaid, and to a much lesser extent Social Security -- will rise faster than our revenues will, and that just opens an increasing wedge that

we have to borrow.

This has been true for a long time. We knew this was coming, but it's hitting us at a very bad time. It's hitting us at a time when our debt level has risen. A few years ago you might have said, ah, you know, a really serious problem about the aging population and the baby boomers and the rising cost of medical care, but we have time to fix that because we're not in an especially high debt country. We have debt of about 40 percent of our GDP 3 years ago. Well, that's not true anymore. Now it's more than 60, and on the projections even with significant recovery it goes to 80 percent, 100 percent. That's serious stuff.

And the real question is what Bill posed: Can we get back on a sustainable fiscal track which will take reducing spending and increasing revenues? Can't we get back on a sustainable fiscal track and still invest in our future?

Now, basically, I'm only optimistic because we have to get back on a sustainable track. Whether we can do it without killing our future investments is going to be really, really hard. And that's what these sessions have been about, because everybody who hasn't quite caught up with the realities will say, well, yeah, right, we got to fix the fiscal thing, but we can't hurt the most vulnerable we can't hurt national defense; we certainly don't want to hurt research or innovation or infrastructure. But,

you know, that's most of it.

MR. ANTHOLIS: So from a math standpoint, how do you do it? Give us a sense of -- the two commissions had a lot of overlap. There were some differences, but where are the biggest savings? Where do the biggest savings have to come from?

MS. RIVLIN: You do everything you can possibly think of. And that means first reforming the tax system so we can raise more revenues with a simpler and more pro-growth tax system. This is an enormous opportunity to do that, and we may also need a broad-based consumption tax which states will not be happy about because they tax consumption, right? But that's certainly a possibility.

We need to reform Medicare, and we need to reform Social Security, although that gets a lot more attention than it really deserves. It's a small part of the problem, and we've got to make the other parts of the government, defense and discretionary domestic spending, a lot more efficient and find new ways of financing the infrastructure that we need. That's not going to come out of the usual sources. We have got to finance infrastructure in a much more intelligent way, which I think means load use fees instead of a gas tax, congestion fees to reduce congestion, and a lot more tolling.

MR. ANTHOLIS: So Senator Bayh, you've been a well-

spoken critic on the inability of Washington and particularly the other end of Pennsylvania Avenue to get things like this done. So on both the politics and the substance -- on the politics, even though we're facing this cliff, can we apply the brakes in time before we go off of it? But on the substance side, Republicans say we don't have a revenue problem, we have a spending problem. Are there Democrats that are willing to make hard choices, particularly on things like health care costs, essentially reforming health care yet again, in order to hit the brakes before we go off the cliff?

SENATOR BAYH: Well, the answer to that, Bill, is yes, but it will not be easy at all. And first let me start by thanking you and everybody at Brookings for hosting this. From my time in government -- and I miss being governor because every year, as you know, we had to give State of the State Addresses, so it forced me to take a couple weeks and take the longer-term view. Congress, that doesn't happen that often. But there's no question that the finding or comparative advantage economically, and innovation is going to be key to that, drives everything else.

We've in the last week or so seen an extraordinary situation where the Secretary of Defense is proposing reforms in the Pentagon because of his view that we are entering an age of fiscal austerity from a

budget standpoint. So this dialogue we're having here today literally touches upon every facet of the government and American life, and how we resolve it is going to define our country for the next generation at least, perhaps longer.

So to get to your question, I'm an optimist by nature, but my experience on the Hill for 12 years has perhaps taught me to be a little more skeptical about the ease of which these things can be addressed, particularly because of the political dynamic.

My own guess is that the following will happen: that there are going to -- it will take exogenous events -- the debt ceiling limit we're going to bump up against. That's something that can't be avoided. Just like the expiration of the tax cuts on December 31st couldn't be avoided. That forced the Congress to act. We can't allow the country to default. My guess is we'll bump up right against that. You may see a couple of temporary extensions. But ultimately it will get done. But the price for that getting done will be some real fiscal reform, perhaps including broad-based tax reform, somewhat along the lines that Alice was mentioning. Spending -- the Democrats will have to be willing to say we'll agree to some spending caps going forward. The Republicans perhaps will have to agree to a reform of the Tax Code that will award investment savings, make it more efficient, get the corporate rate down to make it more globally competitive

but at the same time will generate more revenue for the government.

So, there are agreements and compromises there to be made, but the overall political environment right now -- and through my father I've been around, you know, through the process for a long time. I've never -- with the exception of the 1960s during the time of the Vietnam War, some racial tensions, those sorts of things, I can't recall the political environment being as polarized and as difficult as it is today. So, that will make progress more difficult. But exogenous events will force progress. There will be episodically occasions when enlightened self-interest on the part of both parties will lead them to strike compromises.

For example, in my legislature when I was governor, the Democrats controlled a few years, the Republicans controlled a few years, it was split a few years. People who are in power -- the Democrats controlled the White House and the Senate, the Republicans can now control the House -- are held accountable. And so it's not -- you just can't, you know, howl at the moon; you can't just make, you know, prognostications without some grounding and substance. So, I think that pretty quickly both sides will see there's an election coming up. Even though they disagree on most things, it's going to be in their enlightened self-interest to get a few things done.

With regard to the topic of innovation, I would say Don't Ask,

Don't Tell is coming up for renewal. There is some prospect there for some progress on education reform.

GOVERNOR RENDELL: No Child Left Behind.

MR. ANTHOLIS: No Child Left Behind.

SENATOR BAYH: I'm sorry, No Child Left Behind. What did I say?

SPEAKERS: Don't Ask, Don't Tell.

SENATOR BAYH: No Child Left Behind. I was going to say on the area of immigration reform, we're not going to have the DREAM Act or something -- broad-based immigration reform -- but perhaps something on ensuring that the brightest inventors and entrepreneurs can come to our country and remain in our country. You could see some progress on that.

Green energy. I think there's a --

GOVERNOR RENDELL: Huge effort.

SENATOR BAYH: The Republicans will want us to be more energy-independent, less dependent on imports of oil. Democrats will like the implications for CO₂. So, there's some progress there to be made.

Protecting intellectual property, which at the end of the day if you -- you can innovate all you want to. If other people steal your ideas, it doesn't benefit you economically quite so much. So, perhaps a more

rigorous regime of intellectual property protection.

There are some things when the sides can come together even if the overarching narrative is one that's pretty disagreeable.

That answer your question?

MR. ANTHOLIS: It does, and on two -- for those who weren't here earlier, we have two policy briefs that we've just released today on two of those issues actually: on reforming immigration for high-skilled workers and also on having to do with intellectual property vis-à-vis China.

SENATOR BAYH: One other thing in the context of the tax reform, which I really do hope we can grapple with as we're dealing with the debt ceiling: making permanent the R&D tax credit is kind of a no-brainer.

GOVERNOR RENDELL: Absolutely.

SENATOR BAYH: I'd be a part of that. I mean --

SPEAKER: Crucial.

SENATOR BAYH: Yeah, I mean, those of us up on the Hill or used to be up on the Hill, we liked it having to be renewed, because it made people come to us and ask it to be renewed. But as a matter of policy, it ought to be made permanent, and I would hope that that could get done in the course of that debate.

MR. ANTHOLIS: So, Ron, you've spoken about the bipartisan failure to address the debt issue, and you've also lived on Capitol Hill through times when Democrats and Republicans with a lot of fighting both within the parties and between them figured out a way to work together. Is it possible this time around? It's an intensely polarized environment. On the Senate, I think the most liberal Republican -- and there are two from Maine, Senator Snow and Senator Collins -- are to the right of the most conservative Democrat, Ben Nelson in the House. It's not that much different. And that's a real sea change. Things are a lot more polarized structurally on the Hill than they were. And then within the Republican Caucus on one of the issues that Senator Bayh talked about as an action-forcing event -- the coming up of the debt ceiling -- there doesn't appear yet to be consensus within the Republican Party on how to deal with that. How do you see it on the Hill, and particularly on the Republican side? Will -- is there a coalition for common ground?

MR. HASKINS: Let me begin with a little personal story that the other members of the panel might enjoy.

Last night I went home and had all my books and I put them down on the kitchen table and it just happened that the agenda for this panel was on the top. My wife came in a few minutes later and she looked at it, and she said, wow you know, a governor and a senator, the great

Alice Rivlin, a great business executive. Who the hell is this guy Haskins?

(Laughter) So, the other panelists, I want to thank you for enhancing my reputation. My wife, I'll tell you, would appreciate that.

I think I'm like Senator Bayh. I hadn't heard him say that before, that I'm inherently an optimist, and I've seen a lot of amazing pieces of legislation go through the House and the Senate and pass that people said would not pass: welfare reform, many others. But I think 15 years on the Hill when a couple of years in the White House have convinced me that we're a long ways from any serious solution to our problem, and it's questionable whether we'll get there before we have a really serious outside event. So, I'm not optimistic. But if you do a kind of mathematical thing here and figure out what are the factors that tend to push toward some kind of an agreement among Republicans and factors that are -- would oppose it, I think the first thing, there have been some really hopeful signs. Alice emphasized this.

By the way, Alice's office is mine. I try to go by there as often as I can, because she's really optimistic, and it makes me feel better, even though I don't agree with her. (Laughter)

So, Republicans are serious about cutting appropriations. The government might not like this, but I'll bet they do it. I'll bet you that they get the 50 or 60 billion. I don't think they'll get to a hundred. But if

you look at appropriations, they put defense off and things that we know they're not going to cut, like the FBI, and these are some really serious deep cuts. Some programs are going to get 20, 30 percent cuts. And I think they'll do it. They're really on -- and they probably won't become law, because I don't think the Senate will go along. But that will be an interesting dynamic if the House passes and sends them over there.

Second thing is that I think it's just completely shocking -- there's not a single person in this room that could predict anything like this were to happen -- and that is that Crapo and Coburn signed on to tax increases. That is enormous, and especially for someone who hangs out with Republicans. That antipathy toward increased taxes is shocking. It passes any human understanding that Republicans are so, you know, opposed to taxation. So, the fact that Coburn -- there are not very many who are more conservative than Coburn -- would sign on to something that involved tax increases I think is a big deal.

Third, I think Ryan is a key here. Boehner is a key, too, but I think Ryan really understands this stuff. He's spoken here at Brookings. All of this is -- I've read his material. Most people don't really like his solutions, but they're real solutions. And he's a real leader, and I think he will force the House and force the House leadership if necessary to do something serious.

And then the most important thing potentially is the philosophy of the Republican Party. I mean, this situation is made for Republicans to do what they want to do, which is reduce the size of government. Now, they love to vote for increased spending so they can be elected. But intellectually, Republicans talk ad nauseam about a smaller government, and what better situation to actually do it than the one that we're in now?

But there are some indications on the other side, too. I think one of the most important is a rule that was just passed in the House the Republicans have favored all along. I think they had a mathematical genius who figured this out, and what they figured out was if you increase spending by a trillion dollars, that really is a trillion dollars that will increase the deficit by a trillion dollars. But if you cut taxes by a trillion dollars, that's not really a trillion dollars. So, the tax cuts are exempted from the budget rules, which is just bizarre. And the thing that really bothers me about it that is one of the most effective budget process mechanisms that Congress ever invented. It actually did have some effect. And now it's been more or less ruined.

The final thing is, I think, really important notwithstanding the fact that I think Ryan is a great leader. The leadership on both the House and Senate side I think are really untested in something this dramatic that

will really take very, very serious compromise and giving in on both sides, and especially now with the new Republican membership in the House. I was in the House when there was a staff on the Ways and Means Committee when there were 75 freshmen in the House and they were all wired, and they were going to change Washington and, by golly, Washington was never going to change them. Compromise, no, we're not going to compromise. It's defeat. Compromise is defeat and so forth. And there are a lot of freshmen that feel that way in the House. And the only solution known to man or God is great leadership.\

Now, no matter what you think about Newt, Newt was God in 1995 and 1996, and Newt really, really ran herd over Republicans in the House. I can remember -- you may remember Republicans shut down the government. Clinton was absolutely cleaning Republicans' clock. And Gingrich went back for about the 400th time to get a deal. He got a deal. He brought it back to the House, a big session with all the House members there. A very dramatic session. Newt gave, I would say, a 20-minute talk about, you know, what was in the deal. It was a brilliant talk, and when he got through he looked at them and said, and this is the best we can do. It may not be the best deal, but this is the best deal we're going to get, and if you don't take it, you can find yourself another Speaker. And they took it. Which I think -- when people went in that

room, very few people thought they were going to take it. So, that's what it takes. And maybe Boehner's going to take it out that way. Alice is very optimistic about Boehner. Maybe McConnell will turn out that way, I don't know. But it isn't clear now that the leadership that is needed will really be present. So, I am not optimist. (Laughter)

MR. ANTHOLIS: So, Ann, I'm the R&D Division of a company that's not sure whether or not it's going to actually have a product for you to sell, but the product that appears to be coming your way is not liked either by the engineers or the assembly line. But everybody's saying we have to get it out there. Otherwise, the company fails. How do you sell that to consumers?

MS. FUDGE: I think one of the things that -- let me -- first of all, I want to make a comment to what Ron said about Senator Coburn, and I'm going to use that as sort of the platform for my other comments.

Your comment was you were surprised that he supported tax increases. If I made another statement that would be equivalent to that it would be that he supported the recommendation of the Fiscal Commission, which meant that we would deal with spending and we would deal with taxes, which comes off in a very different manner in terms of the interpretation of the statements. And I think when you look at in the context of what actually for several senators, whether it was Durbin and

the fact that Social Security was affected by the recommendations or taxes, back to your simple mathematics, the truth of the matter is we had to deal with both sides of the equation to begin to tackle the problem.

I say that to say this. In communications to consumers it's about what we say and how we say it. The facts are the facts, but what is highlighted and what is perhaps diminished impacts a person's perception of the issue.

During the course of the eight months or so in serving on the Fiscal Commission, one of the things that I was most concerned about was had we done a good job of helping people understand the depth of the problem. And so there were many efforts that were undertaken to do that, whether for those of you who may have seen the *New York Times* article when it -- they had a whole page on here's how you can solve the debt; the debt's a problem and, you know, here's -- here are the levers that you could push. That was a way to help people try to understand the complexity of the problem.

Believe it or not, there was an app that was put together so that young people could look at how we tackle the problem, understanding both sides of the equation. The interesting thing about communications today versus 20 years ago or communications of the 21st century is that there are -- there's no one mass market communication platform anymore.

There are multiple and there are multiple consumer segments, which means that as we try to communicate the urgency of today's problem and what the potential solutions are, then we have to come in at a very micro level. Coming up with one big, you know, macro message is not going to work. And I think one of the things that you see -- I have to smile -- I don't know if a lot of you know that Pete Peterson started his career in the advertising business, but one of the things that his organization has done is come out with these ads, and you can decide whether you like them or not. But they are trying to increase awareness of the problem. It's the huge debt ads that talks about, in a very interesting way, the problems that we're dealing with. That's one factor, and that's one way to go about an en masse level.

On another level, there are several groups out there now who in their own way are trying to get groups of people together to talk about the problem and to talk about possible solutions. This is a very challenging problem. One of the things that I think Governor Rendell spoke to in his opening comments was what they have done in Pennsylvania in terms of addressing both the cuts as well as the investment. If there was a phrase that I would use in terms of helping people understand what we need to do, it's the "cut-and-invest" phrase, which we tried to incorporate many times during the course of our

commentary in the report. We're in a world where, like business has been doing for the past 20 years, there's not enough money to do everything we want to do. So, through productivity and really conscious look at what can we afford and what do we have to cut, that's been the approach that's kept business, you know, at a point of trying to thrive through some very challenging times and not having sufficient money to invest. But it is that balance of cutting and investing, so if there were a phrase that as a marketer I would like to begin to inculcate more in the conversation, it's that we need to cut and we need to invest. There's no one or the other. It is not either/or. We have to do both. And I think part of the story will be what individual states have been able to do and how we raise the profile of what state actions have done to keep states afloat and how then we might be able to use that on a broader national level.

MR. ANTHOLIS: In Greece, cut-and-invest leads to riots in the streets. How does it play in Germantown?

GOVERNOR RENDELL: It's worked, I think, fairly well in Pennsylvania. Actually, I just left Building America's Future, the infrastructure organization that I chair with Governor Schwarzenegger and Mayor Bloomberg, and someone suggested we stop using the word "infrastructure," which people glaze over, and start using the word "future structure," which may or may not be good.

But I want to just comment on what Ann said about invest. We've got to change the dynamic. We've got to convince the American people there's good spending and it's investing in things that are important like our intellectual infrastructure, our physical infrastructure, our growth, and bad spending; and we've got to discern the difference between the two and we've got to cut and eliminate and get rid of the bad spending, but we can't do it at the cost of stop investing.

I was on George Stephanopoulos' show in January of last year, and they played that tape of Mike Pence talking to the CCAP Convention, and he was pounding the table saying we're the party of no. We say no to spending, no to borrowing, and no to taxation, et cetera. And then they came back to me and said what do you think? And I said it's a recipe for disaster. If we stop investing, there isn't a business in this country that's grown successful that didn't invest in its own future, and if we do that we're cooked. So, FOX, being interested in blood sport, invited Congressman Pence and I onto the same show, and he gave the same riff. He went first, gave the same riff. Then it was my turn, and I said Congressman, you seem like a reasonable man to me -- and truth be told, he didn't (Laughter), but I've learned on TV you want to be the nice guy. So, I said you seem like a reasonable man to me. Tell our viewers how we're going to keep our roads, our bridges, our dams, our levees, our

ports, our water systems -- how we're going to keep them safe and working effectively and efficiently so we can compete economically and we can have a sense of safe wellbeing about it? How are we going to do that if we don't invest in their upkeep?

And he really was silent for about 10 or 15 seconds, and I think the question had never been phrased that way to him. And finally he said -- the best thing he came up with is there you Democrats go again, using the word "invest" when you really mean "spend." That was the sum of his answer.

So, we do have to find a way to get that message across, maybe not inside the Beltway, but we've got to find a way to get that message across outside the Beltway in hometowns. You can't stop investing. No business does it. If we stop investing, we are fast on our way to being a second-class economic power. No question. No ifs, ands, and buts about it. The American infrastructure, in case you haven't noticed, is crumbling. It's crumbling right before our eyes, and no one seems to have the will to do much about it.

MR. ANTHOLIS: Sticking on the infrastructure point, Alice, Senator Bayh, Ron, other than the Transportation Bill, how much appetite and how much budget bandwidth is there for investment, or are there ways to structure, like what the governor was suggesting before about a

capital budget for the federal government? We heard Jeff Immelt, for instance, earlier today being not particularly optimistic about an infrastructure bank. Where could this lead or where won't it lead?

MR. HASKINS: Well, first, Ed, you may be pleased to know that the congressman may be about to receive enlightenment because he's thinking about running for governor of my state. So, he may have a different view of some of these topics the next time you're on a panel with him once he's had to confront reality. But he may have a different take on federal aid to states, too.

It is true that, as the governor was saying, not all spending is created equal. Some spending has a more profound effect on productivity, efficiency, job creation, those sorts of things, and we should probably prioritize that in a constrained fiscal environment, so we're going to set priorities. I would just emphasize that we need to differentiate between the short-term and the long-term. We may not be able to sustain the levels in the short-term that we desire. We may need to prioritize first tightening the belt and getting the house in order, but then quickly pivot once we've accomplished that to prioritize investments in those things that really do pursue our comparative advantage, lead to innovation in both physical and intellectual capital. That's the way I'd look at it. So we may be in for a period of two or three years.

GOVERNOR RENDELL: Evan, may I ask a question?

When I became mayor of Philadelphia, we faced the biggest deficit in terms of percentage of revenue than any American city ever did. I cut everything and people were furious and everywhere I went I was picketed and whatever. But I managed to use the capital budget to invest in our growth and create some jobs and economic vitality. Why is there such a resistance? I've never been able to figure this out. Why is there such a resistance in Washington to establish a capital budget? Every other political subdivision has it. Most businesses do it. Why is there an aversion to it?

SENATOR BAYH: I've never been an appropriator, Ed, so that probably gets into the particular dynamics of the appropriations committees and who gets credit for the projects and things like that. But on a theoretical scale you're absolutely right that it ought to be done from a management standpoint, but we're dealing with Congress here and how the Congress operates and that gets into the realm of psychology or some might suggest abnormal psychology.

MR. ANTHOLIS: Or parapsychology.

MS. RIVLIN: I think there actually are --

SENATOR BAYH: Economics and politics and you're talking about one and the Hill is the other.

MS. RIVLIN: The fear of budgeteers about establishing a capital budget is that it becomes simply an excuse for more borrowing. I think the key to financing infrastructure is we've got to charge for the use of the infrastructure in sensible ways. At your level, the state level, you actually do some of that or you do it at the local level. You do borrow for infrastructure, but something has to back those bonds, a dedicated revenue stream of some sort. At the federal level we have not been used to doing that so that the budgeteers have thought there they go again, those infrastructure folks. They just want to add to the federal debt and the federal debt is going up very fast already and we can't add to that. So it's got to be a different kind of thinking about how you finance infrastructure at the federal level.

The other thing is I think the reason there's been resistance is it's very hard to define what investment is in the federal budget because the federal government doesn't actually do a lot of infrastructure itself. It's grants, and if you think of long-lasting stuff as physical investment, most of it is military in the federal budget. So it is very different from looking at a state budget.

SENATOR BAYH: Can I just make one other point? I'm going to follow-up on something Ron said. It seems to me that we have the gamut of the spectrum here. We have the optimists, we have the

pessimists and I'm the agnostic, so we have every point of view represented. But if Ron is correct and the debt ceiling vote is not really the precipitating event to at least begin to make a down payment on addressing the fiscal problem, then the next step along the road will be either a substantial depreciation of our currency not in an orderly way but in some sort of a precipitous way or a spike in interest rates. It will be some market reaction. The market will ultimately impose discipline in the political process. But at that point the imbalances have gotten to such a size that dealing with them will be even more painful and disruptive so that's why I'm hoping that cooler heads will prevail and we'll have this initial exogenous event serve as the trigger rather than waiting a few years down with something that's so much larger and more difficult to grapple with.

MS. RIVLIN: Exactly.

MR. HASKINS: I want to just expand on that for one second. This distinction between investment and other spending is one I think that everybody appreciates and I'm not surprised that your story about Pence turned out the way it did because everybody think investment is a good thing especially investment in human capital which the federal government do a lot of. This is a great reason why we have to deal with the deficit now, because if we deal with it in an emergency in any of the

events that you just described, it's going to be like Gramm-Rudman-Hollings for those of you who remember. We're going to have across-the-board cuts, we're not going to be careful about the cuts and nobody is going to have time to think about if we do this, this will happen. We need reasoned debate about this. We need so start now and have an orderly, reasoned debate where the ones with the most votes win and that there is some room for bipartisan compromise. So to me your point about investment is really the point about why we need to get started and do this now and not wait.

MS. FUDGE: Ron, just to add to that point, it was a point that we made consistently in the deficit commission about now because the longer we delay an action the more difficult the decisions become. So one of the reasons that we put forth some very specific opportunities to make cuts in some very specific sort of frameworks within which to look at tax reform, simplification, et cetera, trying to deal with the corporate side so that we don't fall further behind competitively, I think we have a template. The question is will our Congress use the template as a way to have serious discussion so that we can have actions before, you're right, we get into a situation that not very wise decision are made.

MR. ANTHOLIS: Why don't you go, Alice? And then I'm going to turn to the audience and start fielding some questions because

we're going to lose Governor Rendell in about 15 minutes?

MS. RIVLIN: I wanted to build on this conversation and what the senator said because the definition of an optimist is not somebody who thinks we're all going to sit down around a table and agree on things. It's not going to be like that. The definition of an optimist is someone who thinks much of the political system will get it in time, will understand that we can't let this catastrophe happen so we have to act. And they may not all way to act in the same way, but it'll precipitate a negotiation. That's the definition of an optimist.

SENATOR BAYH: As Ben Franklin once said, "We must hang together or we shall be hung separately," so we're kind of in that situation here. One last tidbit and let's get to the questions. With regard to the debt ceiling vote, I wouldn't be a bit surprised, I hope it won't come to this, but you may see a scenario where we're going to tiptoe right now, nobody in the House is going to vote for this: the Republicans because they ran on a platform of fiscal austerity and getting the deficit under control, the Democrats because they're now in the minority and they're going to say you guys wanted the majority, you wanted to make these tough decisions, so go for it. We're not going to vote to raise the debt ceiling. You'll just beat us over the head with it. So it's going to be very hard. And it won't be easy in the Senate, but it will be much harder in the

House.

And I wouldn't be a bit surprised if we didn't see a repetition of what played out around the time of the initial TARP vote. If you'll recall, the markets were all on pins and needles. It was really a very precarious situation. Nobody wanted to vote for that in the House either. The first vote, it went down, failed, and the markets then dropped precipitously, and within 48 hours people concluded we can't have that. It took the market. It took outside events to force the political process to do ultimately what needed to be done so that you might see a repetition of something like that.

MR. ANTHOLIS: I want to turn to questions from the audience. Before doing so I'm tempted to point to the 800-pound gorilla in the room, which is the weight of health care costs on the budget moving forward. But if there's not optimism about raising the debt ceiling, which is relatively easy, then I can't imagine that there's optimism about that. Why don't we go to Darrell and then I'll field a few more questions?

SPEAKER: This is a question for Senator Bayh, although anyone else who wants to comment on this is free to do so. It seems like Congress has just become so dysfunctional in terms of inability to address problems, extreme polarization, and hyperpartisanship. In the Senate there are all these rules changes that interfere with the institution's ability

to get things done. Having served on the inside of that institution, if there were changes that you could make to improve the performance of that institution, what would those changes be?

SENATOR BAYH: That's a longer conversation. There is a robust debate going on within the Democratic Caucus and this will come to the fore here pretty quickly about whether to change the rules on the filibuster and if so how to do that. My best guess, right, and there's this whole debate about whether under the Constitution the Senate can write its own rules on the first by a simple majority vote. I don't know whether that's going to be put to the test or not. My best guess is that there may be something negotiated informally between the leaders that will lead to a reform of the filibuster, but still requiring the 60-threshold vote requiring more members to actually be on the floor physically to filibuster and a number of those kinds of things, so I think that's one thing that just gums up the works. We didn't even bring things up. The mere suggestion that it might be filibustered keeps things from even being brought up, so that's certainly one of the things.

I think we need to find a way to get some of the younger members more actively involved. It's interesting in that the Democrats and the Republicans operate differently in the Senate. The Republicans rotate the chairmanships I think every six years; the Democrats don't, just

in perpetuity. And we have such large freshman and sophomore classes that he is working to try and get them involved a little bit more and they tend to have a little bit more of a reform instinct about them and that would be a good thing.

Another thing is anonymous holds. You can stop Executive Branch appointments and nobody even knows who's doing it, so at least having to announce who you are and articulate why you're doing what it is, that seems to be a fairly sensible step to take. So I would look for some modest changes perhaps not within a formal vote because that would cause all hell to break loose on the filibuster, probably the reform of the anonymous hold, some of those kinds of things.

And Senator Begich has been appointed as the representative of the freshman class or the sophomore class now to the Leadership Committee, and look for Mark Warner. He's somebody who's really stepped up and is taking a leadership role. Joe Manchin, he is, as I was saying in my remarks beforehand, is going through the difficult transition of having been the chief executive and now being 1 of 100 and having an office in the basement of some building.

I'll share with you one story and we've got to get on. Here I've been governor and I had a big ornate office. My Chamber of Commerce comes to see me my first week in the Senate and I had a

temporary office in the basement of the Dirksen Building, and the trash receptacles you had to go past to get to where my little cubbyhole was. The head of the Chamber looked at me. They were all kind of hesitant and didn't want to say anything. He finally looks at me and said, "Evan, who did you piss off?" Joe may be one of those guys. He's still got that governor in him and wants to stir the pot a little bit and he might be another one to look at.

MR. ANTHOLIS: I want to direct a little bit of this question to Governor Rendell. On the one hand, you've got your own set of issues with your state legislature on how to get things done. When the political class or the broader people who you talk to in Pennsylvania look at what goes on in Washington, particularly in the Senate, is it discussed or is it just off the radar screen and they're not really paying attention to it?

GOVERNOR RENDELL: Half don't pay attention it and half just shake their heads in bewilderment. I think, Evan, and correct me if I'm wrong, that when we had the 59 votes of senators, 41 senators representing 18 percent of the American population could stop something from happening in the United States Government. Absolutely ridiculous, just ridiculous, infuriating. I actually called David Bois and I wanted to as soon as I left office be the plaintiff in a taxpayer suit to say that the filibuster rule was unconstitutional because I believe -- I have no legal

basis for it, I just know it has to be unconstitutional.

SENATOR BAYH: David will find one.

MR. ANTHOLIS: The gentleman in the blue sweater. Wait for the microphone. And tell us who you are, please.

MR. DZOMBECK: Dan Dzombek, the Motley Fool. I'm also a Pittsburgher for Governor Rendell.

Alice, you had said we need new ways to finance infrastructure. What role do you see selling infrastructure to investors playing? And Governor Rendell, could you talk a little bit about the challenges to placing tolls on roads to invest in new infrastructure?

MS. RIVLIN: It depends what kind of infrastructure you're talking about and I'm not a big fan of selling a whole lot of things to investors unless it's a really appropriate place. But what I have in mind is shifting our highway financing, for example, to road use pricing. And the gas tax is a diminishing source because of more fuel-efficient vehicles and it doesn't charge you for the use of the road or for driving on a congested road, so it doesn't have the right incentives.

GOVERNOR RENDELL: I would say the first thing the federal government has to do in reauthorization of the Transportation Act is lift the ban on states tolling federally accredited highways. It's insane. The theory is we don't want our taxpayers to pay twice. That's like saying

you pay money to buy a car, but then you're not going to pay money to maintain your car. Ludicrous. Nobody would do that. Right now the law is other than the states that have been grandfathered, we can't toll a federal highway where federal money was a portion of the construction cost; not even the majority but a portion, we can't toll it.

There are supposedly three pilot programs and none of them have gotten off the ground. It's insane. I-80, which I wanted to toll and the federal government turned us down, I think we lost on the altar of health care, but nonetheless I wanted to toll I-80. I-80 goes across the length and breadth of Pennsylvania up in the mountains. It's impossible to maintain. We spend \$80 million a year just maintaining it in C to C+ condition. We wanted to toll it and spend \$200 million a year maintaining it and use the extra money to help us with other highway stuff, and we were turned down. It doesn't make a bloody bit of sense. And if we're not going to get the money to do transportation infrastructure from D.C., and it doesn't look like we are, and we're certainly not going to get anything that closely resembles the Oberstar proposal, then they've got to let that happen, number one.

Number two, we've got to get the private sector involved in infrastructure in this country in every way. In every way. If we're not going to be willing to step up and fund for ourselves, we've got to do it.

The private sector, I am told by Felix Rohatyn that there is at least \$130 billion right now ready to go in American funds and in European funds that are ready to be invested in American infrastructure right now where there is a reasonable return on investment, and we ought to be doing it. We ought to legalize it in states where there are barriers. There ought not to be any federal impediments to it. I don't think we sell. I think we lease. The difference is if we lease as a term of the contract we can control when tolls go up, we can control the maintenance schedule, and we can control certain things. We have to do it. We have no choice.

MR. ANTHOLIS: What is the public appetite for that? Do you think the public will be willing to do it if they think the services are --

GOVERNOR RENDELL: If the public realizes that there's no other alternative then I think they'd be willing to do it. When we were talking about leasing the turnpike there was a big outcry, you're going to turn it over to foreign investors and the leading bidder at that time was McCrery. And I said, yes, we really have to worry about our Australian terrorists. Then a Spanish company was the winning most successful bidder and I said to the public if you don't want them, nobody flies into Disney World anymore because they operate the airport in Orlando.

SPEAKER: Governor, I just wanted to follow-up. My name is Bob. I just wanted to follow-up with your comment to ask the senator

about the experience in Indiana because I understand that in Indiana you've actually sold these highways. To comment more broadly, the whole concept of public-private partnerships where we outsource utility kinds of operations like utilities, electricity generation and railroads, that's an American invention. We invented it and we forgot all about it after the Second World War. The rest of the world has embraced it. I think we really need to do that starting I think with a federal infrastructure bank that can eventually be privatized, so I'm curious as to your perspective.

SENATOR BAYH: The Indiana Toll Road which runs across the northern part of our state was sold to a group of international investors and it helped to fund projects all across the state. It proved to be somewhat politically controversial along the corridor because they felt they were paying the tolls but not all the money was being reinvested in their area, that it going some other places, but we've had a couple of elections since then so that it's in place and going forward.

In thinking about all these things, one of the most interesting pieces of data I've seen in the last several years was from a presentation put on by the Democratic Senate Campaign Committee several years ago. ABC had taken a big poll with 3,000 samples. One of the questions they asked on this poll was out of every dollar that you pay in taxes, how many cents do you believe are wasted? Some people said 100 and some

people said 0, but the average of the American was 42 cents on the dollar. That's not possible because a lot of this is just transfer payments and that sort of thing, payments to interest on the debt and all those sorts of things. But my point is from a political standpoint if that's what people believe, if you're asking them to give more money to an enterprise they believe is wasting 42 percent of it, you need to address that concern.

How does this relate to this discussion? When you're talking about use fees, things where people can tangibly see the results for what they're paying, you're a lot more likely to get public support for that than if you just kind of dump it into the overall general budget and say trust us, this will benefit you. That's one of the reasons that these kinds of ways of raising revenue traditionally are viewed more favorably because can see the results and they believe the money is being used for the purposes they expect rather than being wasted.

GOVERNOR RENDELL: Unfortunately, I have to go. I got the time schedule wrong on this, but I wanted to just follow up on what Evan said. He's absolutely right, it's where, I think, those of us who believe that government spending can and -- can be a good thing and can be targeted to things that are important. If we're going to fight the battle, infrastructure is the best venue for the reason that Evan said, people can see it.

Even in the 2010 election where everyone who wanted to spend any money was bludgeoned to death, 61 percent of the transportation infrastructure ballot initiatives that required either increased borrowing or increased taxes passed and they passed by 64 percent of the vote because they were tied to a specific project. It wasn't give us money for infrastructure broadly; they were tied to a specific project. We're going to widen that bridge from two lanes and you sit for a half-hour each day in the morning and a half-hour at night; we're going to widen it to six lanes and it's going to cost X, and we want a toll or we want to borrow or we want to raise taxes. Sixty one percent, in the worst climate for spending probably in the recent history of the U.S.

So, I think we have to do this. We have to find a way to put our heads together to fund our infrastructure. And besides, it's the single best job creator: jobs on the construction site, jobs back in the factories. The first year of stimulus funding for transportation in Pennsylvania -- first year -- \$600 million -- we had 2 years, \$600 million each -- orders for steel increased by 43 percent in the state, asphalt and concrete over 50 percent. Factories hired back workers in the deep of the recession.

And the last thing I want to say, Alice, we've got to change the way we score in Washington. If we went on a \$3 trillion, 10-year infrastructure revitalization program, the additional jobs, the additional

federal taxes, the additional corporate taxes we produced would be -- let's assume the debt service was \$280 billion a year. We figured it out; the additional revenue to the Federal Treasury would be about 120- to \$130 billion. So it's not \$270 billion to the Federal Treasury, it's \$150. But there's no offsets in the way you score down here in Washington, another thing that's nuts.

MR. ANTHOLIS: Ron, what's the -- as the governor is getting his mic off and exiting stage left, so to speak, what's the bandwidth on the right for this kind of thing, first investing in infrastructure but then in particular user fees, pay-as-you-go, all that? Does that make it easier to swallow or do they feel that that's the fox in sheep's clothing?

MR. HASKINS: I think if you call it privatization, there's a lot of support for it. Republicans like things that are private, you know, so I think that's a reasonable thing. And also, the governor didn't say this explicitly, or the senator, but there's a fair amount of evidence now that a lot of these public-private partnerships and leasing out highways and so forth have worked pretty well, and the voters have accepted it. So I think there are good arguments for it, good reason for it, and also, not to be lost is you don't have to raise taxes, and that's a huge deal.

So, I think there is -- this is an example of things that in a reasonable environment, you could reach some compromises.

MR. ANTHOLIS: Great. Next question. I want to go to somebody who hasn't -- gentleman in the green tie back here. Thank you. Thanks, Governor.

MR. GOW: Thank you very much. Roddy Gow, I run Asia House in London. My question has nothing to do with Asia although that's the other 800-pound gorilla in the room. And it's very interesting as a Brit to hear about public-private partnerships because I can assure you, they do work and work extremely well.

I wanted to ask a more fundamental question of the panel because in the previous panels we've talked about preparedness to stand, you know, the argument on its head and really consider what should be done to enable different sectors to function more effectively. In my country we've seen in an almost unprecedented way, facing a terrible economic crisis, the formation of a coalition government. People who we never thought would come together being forced to come together. I would like to ask the panel whether in their view the present political system here works or is working so poorly that the concept of perhaps a redesign along the lines of a coalition, maybe in the short, rather than the long term, but maybe in the long term, is feasible?

MR. HASKINS: I think it's a great question. You could have also mentioned Germany, Spain, The Netherlands, to some extent,

France, all these countries who have taken bold and decisive action, all of them have had great leadership, and they are making progress. Some of them have made remarkable progress, The Netherlands especially because they started earlier.

And yet, the U.S. sits around throwing bombs at each other. We haven't -- I don't think we've done a single significant thing in the House and the Senate that they agreed to that -- we can agree to spend more money, we can agree to cut taxes, but to actually take decisive steps to solve this problem, I don't think we've done anything.

Now, the idea of changing our form of government, going to a parliamentary government or some such thing, it just scares me to death. I bet that scares you, too. Because you never know what you're going to come up with, so I don't think that's possible.

I think the real problem is the mindset of leaders in -- of political leaders in America today. There was a time when people realized, you know, we've got to get this done, we have to cooperate, we'll yell at each other out there on the floor, but we'll get the votes and we'll get it done. And there are all kinds of examples of that in the past. And that mindset of we're going to get a deal, I think, has really evaporated and there's a lot more name calling, a lot more, you know, challenging the other side in the most fundamental, philosophical way, and you don't cut

deals. So, this is a real test. We'll see over the next couple years. Alice is optimistic, and there are indications that -- in the way you said, you know, I recognize that as optimism, but our political system has not been up to it so far, that's for sure.

MS. FUDGE: Let me add to that comment because I travel a lot and spend a lot of time in the UK for a variety of meetings, and it's been fascinating to watch the transition with your coalition government, and I've asked myself that very question, would something like that be possible here in the U.S. And I don't think so, to be quite blunt about it, but here's where I think the opportunity arises: When we as a country are met with a massive challenge, we rise to the occasion and we have -- but we have to -- the question I ask is, why do we have to wait for that moment of a massive challenge to be able to act?

We just had an incident here in the states a few days ago and just absolutely unthinkable, and so the question is, how much of this is a moment for us to now step back and think what do we need to do differently? And that's a lot of conversation going on around that. Government-wise, I don't think we're going to move to a coalition way of operating, but I do hope that we can maybe diminish the conversation around polarization and talk about how we can cooperate to solve the problems which honestly need to be addressed now because time is just

not on our side.

MR. ANTHOLIS: The senator wanted to get in and then I wanted to follow up with the senator on a question on this point.

SENATOR BAYH: I'm reminded of something that a former prime minister of your nation once said about us. Of course, his mother was an American. He said, "The Americans can always be counted on to do the right thing once they've exhausted the alternatives." And so we may be close to that point.

We're not going to change our form of government to go to a parliamentary system, but we may reform the current structure that we have. I mentioned some things in the United States Senate, we may change some of the -- our budgetary processes to find a constitutional way to give the Executive some line item veto authority as most governors have. That's a constitutional issue, but there are some ways to deal with that. Maybe other things in the long run put us on a better fiscal path in terms of changing the balance, but the one thing I would say is from time-to-time, we have a two-party system, that leads to more stability. We don't act as quickly, but, you know, there's something to be said for both. I would say, you know, Ron mentioned a couple of the other European nations. With the exception of Germany, I'm not sure I'd change fiscal situations with any of them. Now, your country is taking pretty aggressive

steps to deal with your problem, but it is bigger than our problem. So, I don't think that really gets to an institutional superiority on the part of European parliamentary government as opposed to our form of government.

The point I wanted to make is that from time-to-time when dysfunction has gripped our form of government, it is not unknown for a third party, a third force to come along. The last time we went through this, I also remember Ross Perot, back in 1992, he garnered about a third of the vote running on getting the deficits down and dealing with our fiscal -- you know, getting our fiscal house in order and all that kind of thing.

The two major parties then tend to co-opt the message of the third part, so I'm not predicting that we're going to have a third party or that sort of thing, but I do think to the extent the two parties get discredited, you might see a third force arise which would attract support of the American people and then that would force one of the two major parties to take action.

MS. RIVLIN: I think our version of coalition government is called divided government and it works to get some things done. I mean, we had divided government from '95 through 2000, and we did balance the budget and get it into surplus and we did pass welfare reform and a few other things. That may happen again. That's part of the reason, I

think, we're not in as bad a situation as we might be.

MR. ANTHOLIS: Since 1960, we've had a much more divided government than we've actually had one-party government, but that does raise a question, I think, that I wanted to direct back to Senator Bayh and maybe to Ron as well, which is there seems to be a very short window for it in this Congress, right, because we're going to have a presidential election in two years, which means we're going to start having a presidential election this spring, summer, or early fall. And at some point once -- on the Republican side -- the nomination process starts up, and at some point the game becomes anything that the President wants to do, the Republican candidates won't want to do, and will make it much more difficult for Republicans in Congress to support any sort of deal with the President. We saw this a little bit in the lame duck session where immediately once the deal was done Mitt Romney, one of the most moderate Republicans, potentially, in the race, immediately condemned it even though conservative Republicans in the deal embraced it.

So, tell us a little bit about that time sequencing in the next year of divided government. When does the window close? We've talked about the action forcing event of the debt ceiling, what does the gaming look like between now and Memorial Day or, at the latest, Labor Day?

SENATOR BAYH: Well, I think six months is about right,

Bill, but you're going to have three different kinds of politics going on. One will be presidential politics and those who seek the Republican Party nomination are going to have to be going to places like Iowa, South Carolina, New Hampshire, and presenting themselves to the most ardent of the party faithful who tend to be more conservative, more ideologically intransigent than even the Republican electorate as a whole. And so the challenge for them is how do they appeal to that Tea Party-type element, but at the same time not alienate Independents and moderates. My guess is they'll lean more toward, you know, winning the nomination first and figuring out how to appeal to the center second. And so, for them, they'll be out there kind of opposing almost everything the President does.

In the Senate, we've got a number of closely -- it's now 53-47, and there are at least that many -- enough seats in play 2 years from now that it could -- the Senate will be in play. And so if you're Mitch McConnell and the minority, you're going to be looking at, okay, how do we position ourselves to try and maximize our chances of succeeding in the upcoming election, you know? And that's going to lead to a little more opposition than not. They're going to say, well, it worked pretty well the last couple years. You know, if we agree with the President only three things can happen: it works and he gets the credit, it doesn't work and we get the blame with him -- there just aren't -- it's not a real attractive way to

go, so more opposition than not in the Senate, which, since we require 60 votes, that makes it difficult to move things through the Senate.

But the third thing I was going to mention is, and this is more on the optimistic side, you then have the politics of the House. Well, we have a new Republican majority and as Ron was pointing out, some of them are fairly ideologically fervent, and so forth, the freshman class. They're going to bump up against reality now and eventually the leadership -- and this is my read on John Boehner -- he's probably a pretty practical guy at the end of the day. They can't go to the electorate two years from now with nothing to show for their leadership. They're going to -- it's concentric circles, where the concentric circle of what the President wants and the concentric circle of what the House majority might support overlap. There's where you can get some things done and both sides will have an incentive to do it because the new House is not going to want to go to the people and say we did nothing but argue for two years. We argued a lot, but we actually got some things done.

MR. HASKINS: By the way, in '95 and '96, that is exactly what happened. Republicans said no to almost everything insisting, you know, they weren't going to compromise, as I said before, and then people sat around and said wait a minute, we haven't done a damn thing. We have this huge agenda, you know, Contract with America, and the

Republicans started dealing with Democrats and passed a lot of legislation so that they could go to the electorate and say that they had made achievements which, indeed, they had.

SENATOR BAYH: One last point of view. Look at the polling following this election, it was more a referendum on the status quo in Washington, number one, and to a somewhat lesser extent, some things that our majority had done that were viewed unpopularly in the public. It was not an embrace of the Republican Party generically or a specific agenda put forward by the Republican Party, so if people are equally unhappy two years from now, they're just -- we're in a mode where they're constantly voting the rascals out. Well, if they have nothing to show for it, they'll be the new rascals. So they're going to have to have something to show for this, otherwise they're going to be the victims of the dissatisfaction.

MR. ANTHOLIS: I think we have time for one more question before the last panel. Let's go to the gentleman all the way in the back.

MR. FANUSÉ: Thank you very much. My name is Yaya Fanusé and I think I'll respond here because I retired from state government of California 2006. I'm forced to ask this question or make a comment because of Senator Bayh talking about the British. Trust me, the United States position is worse than the British. In the short run you

don't see it, so I give you a metaphor from Africa.

When a rat is about to take its last breath, it shakes its tail. So I hope you guys will start thinking that United States is in a very precarious situation and you have to stop using cliché formulas of explaining government efficiency and effectiveness and come up with a really drastic way to solve your problem. Otherwise, you're going to become a third rate nation. I have been here since 1967, this is the best country to be, but you guys are making a mockery of it. Thank you.

MR. ANTHOLIS: I don't want to end without a question, so if we can get one last question before the session goes. (Laughter)

SENATOR BAYH: Sounds like the voice of the electorate from this last election right there.

SPEAKER: I just wanted to -- some of the comments Alice made about tax policy reform having sort of a more pro-investment, pro-savings, cutting the corporate taxes, and things like that. I see measures like that as key to providing the sort of policy certainty that is really going to stimulate the kinds of investment from the private sector in the future, which I think is really the key. And I think that goes beyond budget cuts and things like that --

MR. ANTHOLIS: Is there a question in this?

SPEAKER: Yeah. What's the political feasibility and

timeline, I guess, in terms of doing something like that? In terms of having real tax policy reform along those lines?

MR. HASKINS: I was with Ways and Means Committee staff in '86 when we passed the -- well, most people think it's really a spectacular tax bill, it was right out of the economics textbook -- broaden the base, lower the rates. And there's always an appetite for that. Dave Camp has said that he could go for that. The Speaker said several times that he doesn't like all these tax expenditures which is -- that's essentially broadening the base when you close the loopholes.

I can tell you, though, that that's an example of a bill that there's just no way it could pass, and it did. I don't know how that happened, because the lobbyists were everywhere. I mean, everybody got an (inaudible) and the lobbyists were everywhere trying to kill the bill. And right up until the last minute, I think the smart money was the bill's going to die. Maybe you feel differently about that, but they passed it.

So, I think there is always an appetite for tax reform if it's defined as broadening the base and lowering the rates, but the complication this time is you've got to do it to raise more revenue. That's a tax increase, therefore, you get all the anti-tax fervor that you get from Republican interest groups.

So, I would not predict it will happen, but relative to some of

the other things we've talked about, I think there's at least a chance.

MS. FUDGE: I think like all of these things it depends on whether there's a real sense of crisis that overrides the army of lobbyists who will be there to oppose everything and that's going to take a lot of leadership, as we've said.

SENATOR BAYH: The odds against anything passing in a divided Congress are almost, by definition, more than -- you know, less than 50-50, but I get back to the debt ceiling and the fiscal crisis that we face. There is a precipitating event here and the Republicans in the House, some Democrats in the Senate, leadership positions, some representing the President, have mentioned tax reform as something that they would like to see get done in that context, so I would put the odds of this as higher than normal because something has to get done on the debt ceiling. And if this is one of the things that can be done to kind of make people feel better about what has to be done, it won't just be all take your medicine. There will actually be a pro-growth component to this that some of the business community and elsewhere would find to be a positive thing.

MS. RIVLIN: I was going to say one other point about the business community. One other elements of tax reform that we've talked about in the context of the Fiscal Commission was what we could do to

make the business community more competitive globally, and so some of the tax reform options have elements of it that contribute to that.

MR. ANTHOLIS: Well, with that, I want to thank the panelists, first and foremost, who were just terrific on this, and then also thank you, the audience for terrific questions, for staying with us for this day. We have two more panels left. The next panel is on manufacturing. We're going to go right into it. So, we really do request that people stay in their seats so that we can roll quickly into the next panel. (Applause)

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