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**Moderator:**

MICHAEL O'HANLON  
Senior Fellow and Co-Director, Center on 21st Century Security and Intelligence  
The Brookings Institution

**Panelists:**

ROBERT HALE  
Fellow  
Booz Allen Hamilton

MAYA MacGUINEAS  
President  
Committee for a Responsible Federal Budget

ALICE RIVLIN  
Senior Fellow, Economic Studies  
The Brookings Institution

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## P R O C E E D I N G S

MR. O'HANLON: Good morning, everyone. And welcome to Brookings. I'm Mike O'Hanlon with the Foreign Policy program. Welcome, as well, to the fourth consecutive last week of summer, depending on how you define it. And so, I guess in Montgomery County we are done. Virginia still, the kids are still enjoying one more week. Hopefully some of them are watching on C-Span to celebrate their final week of summer vacation.

SPEAKER: Oh, yeah.

MR. O'HANLON: We'd rather have you all here, and we will be involving you, including on the C-Span telecast, in the second half of our program. We are going to talk today about the broader federal budget, but we are going to begin with the specific issue of the Pentagon budget, and even more specifically than that, essentially the war budget, or as it's more commonly known these days, the Overseas Contingency Operations Fund.

That is a \$60 billion a year thing, it was of course the 200 billion a year at the peak of the wars in Iraq and Afghanistan, so it's still a lot of money, but it's roughly 10 percent of the Pentagon budget. But as you think about how to address the issues associated with this particular fund, you wind up needing to talk about the entire federal budget, and certainly the Budget Control Act, which has given us the pleasures of sequestration and such things over the years, and which could still do so again, just to remind you, this crowd probably needs a little reminding, but the Budget Control Act would still be in effect for the entirety of the next president's term in office.

And so today's discussion is going to be about whether that's a good thing, whether we should revise it, repeal it, that's where we are going to wind up. And of course that raises questions about what's the proper level of domestic investment and of national defense spending, and of the entire federal budget for the United States. And so that's why we have this distinguished panel with broad-ranging expertise.

Let me briefly introduce you to them, and I'm just honored and thrilled to have all three of them with me, and then we'll go to a discussion amongst the four of us. I'm going to ask each one of them, a question or two in broad terms to get things going. We'll talk for a while, and then involve you with your questions and concerns.

The lineup begins with Former Undersecretary of Defense Robert Hale, who is now at Booz Allen Hamilton as a senior fellow. Booz Allen Hamilton has been an important participant and contributor to our defense industrial-based project here over the years. We've done events with Bob before.

He, before this job as I've said, was the comptroller of the Pentagon, the chief financial officer for the Pentagon, during the five years of greatest fun that one could have possibly had. You know, Bob is a Stanford grad in Mathematics. A lot of us when we think about Stanford these days, we are thinking about Katie Ledecky. But for all the pain that she's gone through in the swimming pool in her great training regimens, I don't think it begins to compare to the pain that Bob has gone through in trying to endure sequestration, because he was the guy at the Pentagon who found a way to survive it.

And then some people would say, he almost did too good of a job, because he almost made sequestration seem tolerable in that year, in 2013, when we had it once, and therefore we come close to having it again. To remind you, sequestration is the automatic spending cuts that kick in to bring us down to a lower spending level if there's no other deal, and this is all necessitated by that Budget Control Act from 2011.

Bob has just been a distinguished, and as I say, very patient and very endurable government servant on some of the toughest issues in finance and in management of the Pentagon throughout his career. Previously he had been comptroller of the Air Force; he had also been the director of the National Security Division at the Congressional Budget Office.

And next to him, in the middle, is Maya MacGuineas, my good friend, who is

the president of the Committee for a Responsible Federal Budget, and she also runs the Fix the Debt Campaign. She has been one of the most tireless, maybe the most tireless and persistent people favoring responsible fiscal policy in the United States for the last two decades, and has been exemplary in how she has found many different vehicles through which to get the word out.

Including a great deal of writing, a great deal of testimony with Congress, coalition building, working with younger people whose future is, perhaps, most at stake in many of these conversations, and it's just been an exemplary sort of scholar activist on these very important issues. I'm thrilled to have her.

Alice Rivlin, sitting next to me, I get to say this one more time, because Hillary Clinton hasn't yet been elected president, I hope she will be soon, that's my own personal view, but until she is, until she is, if she is, Alice Rivlin, to my mind, remains the most accomplished woman in American political life and our history.

And I'm not exaggerating, she is the founding director of the Congressional Budget Office, she was the head of the Office of Management and Budget in the Clinton administration. She was the vice chairman of the Federal Reserve Board. And when some people would have called it a career after all that, and interspersed for a number of periods at Brookings when she was writing about important issues of the day, when she "retired" from the Fed, she decided to help D.C. fix its finances as her retirement pleasure or pastime. And she remains just one of our most distinguished and eloquent voices on all matters about the economy, and certainly the federal budget.

And so, after Bob has started by talking a bit about this specific issue of the overseas contingency operations account, then we will get into a broader discussion about the federal budget policy, and really the federal economic policy, and the future of our country for that matter, because that's what it's all about, in the end, as you well know.

I'm just going to say one more thing before beginning with a broad question to Bob, which is -- And by the way, and also going to do a quick advertisement for my little booklet which is about the Pentagon budget, called the \$650 Billion Bargain, but now you know all you need to know. My argument is we should spend about \$650 billion a year on our military, that's a little more than we are spending now. Not a lot more, but a little more.

And that raises the question, well, if we are going spend a little more on the military what about the rest of the federal budget? The Pentagon is only -- DoD is only about 15 percent of total federal spending. Another 15 or 16 percent is all the other so-called discretionary spending that we do as a federal government. And that term for those of you who don't follow this day in and day out, means not optional stuff necessarily, but accounts, programs, capabilities that have to be appropriated each year by the Congress, and if they are not, then there is no money.

Unlike entitlements which is, along with interest, the other two-thirds of the budget, which are all the things that we value as individuals, but which may frankly have less to do with long-term national power. So, if you are thinking about national power, the strength of the country, at least I think of the military, the highways, infrastructure, science research, federal support for education, which is of course a modest fraction of total education spending in this country, but all these sorts of things are in the so-called domestic discretionary accounts.

And therefore, to my mind, are not so discretionary, and they are getting squeezed pretty hard through the budget process that we've all come to know and love as this Budget Control Act with the looming specter of sequestration hovering over our necks every year too.

So that's the broad context, and now I'm going to ask my panelists -- my colleagues to expand on some of these themes. And I'll begin with Bob. And Bob, I'd like to begin by noting, you've often said that the turbulence in the budget at the Pentagon has been

one of the greatest handicaps, leave aside the level, the turbulence and the uncertainty, could you explain a little bit more about that problem, and how to solve it?

MR. HALE: Thanks, Mike. Thanks for the chance to be here. So, if I was looking at the next administration and the financial issues they face, by far the most important would be finding a predictable and reasonable level of funding for federal agencies. I'm going to focus on defense, because I know it best.

As Mike said, since 2010 we've going through enormous turbulence in the Department of Defense. In 2013 we had the sequester cuts which harmed the mission effectiveness, by not leaving insufficient funds for training, and we wasted money, \$400 million paying civil servants during the shutdown, and we didn't allow them to work, and it ate up the time of senior leaders, mine included, time much better spent on other things.

So we need a reasonable, predictable level of defense and other budgets, and the only way to do that, in my view, is a long-term broad budget deal; one that gets us beyond looking at just defense and non-defense, but includes mandatory spending, Social Security, Medicare and revenues, and considers all of those in the context of the deficit.

In that deal I would keep the Budget Control Act, or at least budget caps, because I think the process needs the discipline, but I would raise them for defense, and probably non-defense also, and probably up to the level similar to the current Obama Administration proposal which is well above the caps level, where more than \$30 billion in fiscal '18, and 20 to 30 in the years beyond. So certainly put pressure on overall negotiations, because you'd have an up to deal with, as well as needing to look at some downs.

Now you might say to yourself, I mean, this guy has got to have his head in the sand. I mean the divisiveness of the political debate; how could we ever see such a long-term budget deal. I remain hopeful we'll get beyond this divisiveness, we'll elect somebody as president, and that president, he or she, is going to have to deal with some of these issues.

And I wouldn't say I'm optimistic, but I'm at least hopeful that we'll see a broad budget deal, because I think it's the only solution.

The other issue for defense in particular, the next administration has got to deal with, is the future of the Overseas Contingency Operations, or OCO budget, put in place in fiscal '12, the (inaudible) cost of the Iraq and Afghan War. I just finished a paper, the hard copy is out there if you're interested, on the future of OCO, because although it's a technical topic it is very important, financially, to the Department of Defense.

So, OCO has served DoD well, in my view, and the nation I would say, in the sense that it made sure funds were available so every -- all those actually involved in combat would have the resources they need. And I think there's probably nothing more important for the Department to do financially than that.

It also had some timing problems. The supplementals that were used before OCO were often composed mid-year and acted late, not enough time for DoD to effectively put them in place. But OCO has been harshly criticized, and rightly I might add, because it's increasingly been used to get around the caps. OCO is effectively not subject to the caps, so what we've done is put money into OCO that should have been in the base budget. A lot of bad things about that and if you're interested, we could go into it more.

So what do you do? What should the new administration do? The ideal thing would be to put OCO back where it was before, that they'd use it only for wartime needs. That would probably mean moving several -- tens of billions of dollars out of this war budget into the base budget, given the caps, and given what I said, that they are already too low, I don't think that's practical, so regrettably somewhat, in my view, I think the administration is going to add (inaudible), have to keep OCO, try to keep it back in its box as best they can, maybe make some small moves. But I think a practical solution is going to require that they continue.

So, the biggest importance, we need a broad budget deal that helps Defense

and other agencies get more stability and reasonable levels of budget, and this administration is going to have to do something the next generation, say, about the future of OCO. Mike, back to you.

MR. O'HANLON: Well, thank you. And I'll just do one follow-up question, and then I'll go to Alice and Maya. I'd like to ask a little bit more about the paper itself, and recommend it very strongly. I think a shorter version is being published on NationalInterset.Org this week, and a longer version on the Booz Allen Hamilton website; and it's a very tight read, a very nice pithy read.

But if you could just summarize a couple of the key points, including out of that \$60 billion OCO budget today, roughly how much, you know, has sort of gotten diverted for purposes that would not be optimal if we could imagine doing perfect budgeting. And then secondly, if you have any notional sense of what the Pentagon budget should be. I guess you said consistent with President Obama's latest request. But if you could just sort of spell that out with some rough numbers for the crowd, please?

MR. HALE: Well, for the 60 billion in OCO right now, I mean it's five, and it's explicitly been agreed to by both sides of this debate that would be used for base funding, they just set it higher than the Department thinks it needs for wartime needs. But there's a lot of other money in OCO that at best in a gray area in terms of its contribution to wartime needs. So if you really were to skin the OCO down to be war needs only, I mean, I can give a specific number, but I think as I said in the paper, it will be several tens of billions of dollars, you would need to move out of OCO and put it in the base budget again. I don't think that's practical.

The reason why you don't want base money in OCO, I mean, there's several reasons, but I think the most important one, DoD tries to do long-term planning to have a consistent five-year plan so you don't buy a bunch of stuff you can't support in the out years. OCO is a one-year budget, that's the best you can do. It's hard enough to plan wartime needs



one year in advance.

If you start putting large amounts of the base budget into OCO, you lose all of that planning, consistent planning, you lose the budget discipline. That actually does happen, tradeoffs within the base budget, so I think it's just a bad idea. Paul Ryan, when he was -- before he was Speaker of the House, said using OCO for base needs undermines the budget process. I think he's right. And to the greatest extent we can, we should avoid it. Thank you.

MR. O'HANLON: Do you have a number you would be comfortable with for the Pentagon budget?

MR. HALE: Yes. I mean, I would go with the Obama Administration proposal, it will be in 525 in fiscal '17, maybe a little more if we get a deal out of that, and somewhere in the 545-50 range as we look out beyond, but 20 to \$30 billion above the caps.

MR. O'HANLON: I'm going to just add one point on this, which there's a handout, if you wish, for those of you who are here in person, which tries to summarize some of the numbers. These get confusing. Bob just gave the Pentagon or the Department of Defense base budget, so he did not include the OCO fund in that 525, and he also did not include the nuclear weapons activities of the Department of Energy.

I tend to pull all those together in the -- if you want to look at it in a more global sense, the National Defense function. The 050 federal budget function, that is right now, somewhere just over \$600 billion, and once you've added the base budget, the OCO account and the Department of Energy nuclear weapons' activities.

Just to remind, that does not include the Veterans Administration, the Veterans Affairs, which is another \$175 billion a year in spending roughly, which of course is not relevant to future defense needs, it's the debt we owe to those who have been wounded or killed, and their families, in previous military operations.

It also does not include the Department of States Foreign Assistance

programs, including security assistance to countries that we may be working with in partnership, and it also does not include the Department of Homeland Security. So there are a lot of things relevant to defense in a broad sense, that are not even within that 050 budget but -

MR. HALE: It's an all and non-defense discretion.

MR. O'HANLON: And there are the non-defense discretions, so they are getting squeezed. Some of the VA budget I guess is entitlements, and some is discretionary. So, anyways, depending on what number you are looking at, what definition, in broad terms, I would say defense spending today is just over \$600 billion a year, and so that's considerably above the Cold War average in inflation adjusted dollars, just for a point of reference. But I still think it probably needs to go a little higher just as Bob argued.

With that context, now let's broaden it a little further, and I want to ask Alice what she would think of as an adequate funding level. We'll get into the issue of the Budget Control Act and what the next Congress and President should do in just a second. But first, even though I realize you may not want to give a precise answer to this, I've been struck.

I was reviewing the historical data on how much we spend on non-defense discretionary, and as a percentage of GDP, which is one good way to measure it relative to the size of the economy, in the 1960s it started in the low 3 percent range, went up over 4 percent during the Johnson Administration. Went up to 5 percent during that liberal Richard Nixon's presidency, or at least approached 5 percent, and stayed up there through the '80s.

Ronald Reagan never dropped it below where it is today, 3.3 percent of GDP, and it sort of has been in that low to mid-3 range until the Obama Administration, when it got up into the low 4s in the recovery after the Great Recession, now it's back down to about 3.3, 3.4 percent of gross domestic product, and it's headed down under projections to 2.8 percent, which would be the lowest levels, I think, since the Eisenhower Administration, relative to the

size of the economy.

So that raises the big question of how much is enough for all these domestic investments, Alice, that we know are important to our long-term future.

MS. RIVLIN: With all due respect, Mike, that's a silly question.

MR. O'HANLON: Right. It's a (inaudible) question though.

MS. RIVLIN: It would be nice if one could say, here is a number and there's something sacred about this number. It's silly on both sides of the budget. I one sat down with a group of defense experts, and people with stars on their shoulders, and I was the economist in the room, and they said, just give us a number for how much we should spend for defense, or how much we can afford to spend for defense, and then we'll figure out how to spend it.

It may sound reasonable to them, but what you need to spend for defense depends, obviously, on what the threats are to the country and how we think we should be dealing with them, and we are spending roughly 3 percent of our GDP on defense right now. There was a time when -- and you didn't mention this when you were talking the Cold War, when we were spending 10 percent of our GDP, of everything they produced on defense.

We perceived that we had to do that, we don't perceive that now. The domestic side of the budget is roughly the same situation. In my opinion, the two big problems facing the U.S. economy as we look ahead are, we need to grow the economy faster, and there are various ways you can think of doing that, but there's some obvious ways that we are not doing.

We are not modernizing our infrastructure, our roads, our bridges our highways, and our trans systems, and sewage systems, whatever, all of those things need to be modernized and would create some jobs in the process and some not-bad-paying jobs in the process. So I think infrastructure is essential to looking at the future as it with the development of the skills of the workforce, and staying on the forefront of selling it.

That doesn't tell you exactly what you should spend it for, you should spend it well and on sensible projects and we don't always do that, we don't always do it in defense either. But that's the question we are talking about. But the other big threat that we aren't talking about at all, except Maya keeps trying, is that we are facing, if we go on doing what we are doing in the federal budget, we are facing a growing debt, and a debt growing quite rapidly as you look down the line.

Now, why is that? That's because we have an aging population, and we are committed to Social Security benefits, but more importantly, to health benefits for people as they get older. And we have an inadequate tax system which won't keep up with those spending needs to which were already committed, and is putting inefficient tax system into the bargain.

So, the real conversation that we ought to be having, and Bob suggested this, is how are we going to bring those to budget lines together in the future, the needs of an aging population, and the revenues to support those, that's partly a question of can we deliver health care more efficiently, and it's partly a question of, can we have a tax system, which is more pro-growth, but also more productive in revenue than the one we've got.

I think the answer to that is, yes. We've had a lot of conversations about that, about five years ago when we were in the sense of DOL's mode and another one that Pete Domenici and I chaired. And the President was talking to Speaker Boehner, and everybody was trying to get to the grand bargain. We didn't get here.

The Budget Control Act is a bizarre piece of legislation that was supposed to get us to the grand bargain to say we'll create some cuts in domestic and defense spending which is so unacceptable, but nobody will want to do them. And therefore, they will get us back to the table to do the grand bargain.

Well, it was a nice idea. I thought it was at the time actually, but it didn't work.

And now it's gotten us focused on the discretionary part of the budget, both defense and domestic, and discussing things like the problem of the overseas contingency operations which is essentially a problem of how the Defense Department was able to live with unrealistic caps and seeded a bit into the bargain. And now we are trying to figure out: how do we get back to something sensible?

But something sensible is, talk about what do we want our government to do, and how do we want to pay for it over the long run. And we can't be incapable of doing that.

MR. O'HANLON: If I could follow up before going to Maya for her thoughts on sort of the general budget picture and what it means for our economy, I just want to make sure I understand whether you think that the current track we are on for discretionary spending is acceptable?

MS. RIVLIN: No.

MR. O'HANLON: Okay.

MS. RIVLIN: I think it's much too low, and because of the need to invest in the future. If we just let these entitlement programs which are mainly for older people, and I'm one of those, but they are mainly for older people in the future. If we just let them sort of escalate without thinking about: how do we control the spending, then we force out investment in younger people, and investment in the productivity of our economy, and nothing could be stupider than that.

MR. O'HANLON: Do you have a rough magnitude? I mean, Bob has talked about, you know, being content with Obama proposal numbers on defense. I would maybe go a little higher than that myself, so we are talking about a few tens of billions of dollars added to the annual budget. Do you have a rough order of magnitude for the domestic side?

MS. RIVLIN: No. I don't, because I think you need to look very carefully at proposals for what you would actually invest in, and it should grow slowly over time, as you get

more experience with what works. People are talking now about plugging private sector money in through an infrastructure bank. I don't think that's a bad idea, but I don't think it's going to solve the problem, but the answer is, I don't have an exact number in mind.

But there's got a balancing act between what is productive spending on the one hand, and how much can you slow the growth of spending in the future so that you are not getting onto a worse debt track than we are already on.

MR. O'HANLON: Do you think it's roughly -- Just one last clarifying point. Even though you don't want to give an exact number, that's understandable, do you think it's roughly the same kind of magnitude we are talking about on the defense side; several tens of billions of dollars, you know, plus or minus?

MS. RIVLIN: I think that's largely a political question. It will be roughly the same magnitude because that's the way the Congress thinks, and if we raise the caps on one side we will raise them on the other, that doesn't mean it's absolutely the right number, but on both sides, we need to be thinking about, what should we not be doing, as we invest in the things that are high priority that we aren't doing now.

MR. O'HANLON: So, thank you. And Maya, over to you, I'd love to just get your general reactions to where we are in the conversation, but I'm also interested in sort of how you would prioritize your major economic concerns for the country looking forward?

MS. MacGUINEAS: Right. Thank you. Nice to be with all of you, and nice to be with my fellow panelists. So I'm going to do what somebody does whenever they follow Alice Rivlin, which is pretty much, reinforce everything Alice has just said.

I'll just start by saying, I love spreadsheets. I love spreadsheets so much that my favorite gift of recent years has been from a colleague who gave me a coffee mug saying, I love spreadsheets. I assume that was custom-made, I don't know how one gives that. And then another colleague ran out and got an even larger coffee mug saying, I love spreadsheets

more. So, that's how fun it is where we work in the budget world, and that's how we think of everything. But certainly, I think when you are talking about security policy, it's a great reminder that that's not actually where you start with the question of the budget.

The budget should be something that's bottoms up, and I think this what you were saying, you need to look at what your priorities are and figure out what things are important, and that's most true probably in the issue of security, where, the last thing that you want is budget experts telling you what your securing should be. You want to think through your security checks, your opportunities, your long-term investment, come with your wise security budget, and budget responsibly around that.

I also think that's true for the rest of the budget. We need to think about our national priorities, prioritized them, establish which ones we are willing to pursue, and then bringing in my perspective, think about how we are going to pay for those think about a fiscally responsibility way. And Alice was also talking about this, but with infrastructure, right now, there is a broad-based agreement, and this is a good thing, because there are very few broad-based agreements, politically right now, but there's broad-based agreement that infrastructure is an important priority of our budget.

We'll get into politics, we'll get into what's going to happen under the next President, but if were an area that I think was sort of most likely to move first, that's probably the area. But what you are also seeing is now the kind of one-upmanship that happens in infrastructure. Where somebody will say, well, I think we should spend X-billion more on it, and somebody else will say, I think we should spend X times 2, and because it's free, because nobody is talking about how to pay for it really, suddenly we want to spend X times 100 more on infrastructure.

So, again, part of the disciplining process is, what do we want to spend that money on? And evaluating it, looking at the returns and thinking about it. As part of the overall

objectives of budgeting, which are, growing the economy and doing a lot of important things to meet the needs of the people. So, I think economic growth is critically important. I also think bringing on a lot of issues of economic security which we are hearing a whole lot about in this campaign are very true and are very real.

There also it's a kind of policies we need to be thinking about that reflect the change in the economy. The pace of our economy right now is much faster we've ever seen. And we haven't really haven't updated our social policies, our economic policies to reflect the kinds of changes the people are going through. And I believe that will contribute to growing the economy in a fair way as well.

And you also have to think about the fiscal piece of it. So, where we are fiscally right now, you wouldn't really know it from the headlines. There is a whole lot of talk about how deficits have come down. So, anybody who has read the recent CBO Report will see that deficits are coming back up again. This is quite predictable, deficits came down a lot after our economy starts to recover, but because whenever the pressure comes off Congress starts borrowing more and more.

We actually put in place legislation last year, we had a budget that was supposed to save over 10 years, \$5 trillion and bring us to a balanced budget. I would argue that's probably an overly aggressive goal, and I think that's backed up by the fact that what Congress did is pass legislation, that instead of saving that 5 trillion, added another trillion to the debt.

So, when we do have budgets we seem to ignore them, we are not in a good place fiscally. And so there's a whole lot of questions about how you are going to deal with the fiscal challenges that not only are reflected in the growing deficit, but the fact that right now our debt is at near record levels. Relative to the economy it's the highest it's been since we came out of World War II.



And what's not even that important as where we are today, because we are still lucky, we are the United States our families -- and even when we mess up the global economy, people come here, we are still the safe haven, and that gives us an incredible luxury to get control of these fiscal problems in a timely and gradual way that actually won't derail the economy.

And so we can put in place longer-term plans that would help get control of the record level debt of the deficits, but we haven't. And so what we have today as looking forward, a debt is growing faster than the economy, perhaps the definition of unsustainable, interest payments that are the fastest-growing part of the budget, faster even than health care.

I mean, this is really incredibly vulnerable situation to be in, to have your interest payment grown and so much faster than other parts of the budget. And we are not borrowing for smart investments; we are not borrowing for things that will help grow the economy over time. So, what I look at is, the path that we are on, it's completely unsustainable, it doesn't make sense, it doesn't think about our priorities as a starting point.

And I come to the frustrating conclusion I think many people have, which is in so many ways it's just actually a reflection of a really broken governance system right now, and we have two parties that refuse to work together, even when they have shared objective, shared priorities, they don't even disagree on the ways to fix things as often as you would think. Sometimes I feel like there's a yes, there is an agreement in Congress, and they still call it a no, and walk away from the table.

But disagreements are not, there is an inability to really work together on any of these problems right now. So I guess I would summarize by saying, we have taken the easy way out, the brokenness in Washington has allowed us to do things, like let the sequester hit. Remember when the sequester was built, it was created because it was a policy that was so stupid Congress would never let it go in place. It was supposed to be an action-forcing

mechanism to encourage more responsible choices on the big-picture fiscal situation. Oops, they let it go in place.

And instead of fixing it, replacing it with something else, coming up with the appropriate spending levels, during the trade we were spending more on discretionary and getting longer-term control of our defense -- excuse me -- our entitlement programs, and reforming our tax code in a way that will make us more competitive help good grow the economy and raise more revenues.

Instead of doing that, we did let the sequester hit. And now where we are, we are in a place where we are basically governing by default, only making choices when we have to, kind of when there are action-forcing moments, and really overly focused on short-term priorities. There is no long-term focus, unless to as I think, your point, we need to have a longer-term set of objectives, longer-term budgeting, and put in place some kind of stability so that you can make choices about security policy, about economic policy, and dealing with incoming insecurity.

All the big challenges that we have you can't change if you don't if the -- you can't make plans if you don't know if the sequester is going to be there or not. We've put these replacement deals that are basically two-year plans, oftentimes we've been budgeting in three months at a time, because Congress can't figure these things out, and when we do do these deals they often rely on huge budget gimmicks, OCO has become one of them.

So, we have a long list of things we need to work on, but I think the good news in all of this is, if we do this, if we start to make small bits of progress, and we'll talk more about how, you start to see built-up trust, better policies, more security, more certainty, and you'll see a whole lot of upside in the economy. You are not just doing this because fiscal responsibility is the right thing to do, you do it because it helps contribute to a thriving and sustainable economy. So, now we'll figure out how we get that done.

MR. O'HANLON: Well, that leads to my last question, which I'm going to ask each one of you to comment on. Maybe, Maya, I'll start with you. And then go to Bob, and then maybe Alice, perhaps (inaudible) Rivlin can clean up on that before we go to you for your questions.

And it's the issue of, would it be acceptable or tolerable at least to have a revision to the Budget Control Act by the next President and the next Congress, where the caps go up a bit. We find a way to pay for them somehow. But they don't go up a huge amount, they go up by the kind of numbers Bob and I are talking on the defense side, you know, 20 to 50 billion, and that becomes the new cap, roughly a 5 or 10 percent increase from where we are now; and then similarly on the domestic discretionary side, or whatever the number is.

In other words, is it acceptable to have a revision to the Budget Control Act that keeps the basic mechanism, keeps the basic numbers in broad terms which pluses up the discretionary numbers? Or, do we really need to just get rid of it, and take advantage of this moment to have a whole, new fiscal plan for the country. Probably all of us would agree the latter is better, although I want to hear how each of you will react. When it gets to the question of political practicality, would it be -- whichever is better -- would it be also tolerable to have a revision to the Budget Control Act if that's the best that we could out of the next President and the next Congress. So, Maya, why don't I begin with you on that?

MS. MacGUINEAS: So certainly if that's the best that you can do, you want to have a revision to it, you want to plus up, I think there's no question that when both sides can't live with either defense caps or the domestic discretionary caps, these just aren't reasonable numbers. So, I think plussing it up and offsetting the cost either through revenues, or preferable I think, reforms on the other areas of spending, would make sense if it's not another two-year deal.

I really think these short-term deals do so much damage. But what I really

think is important is, we need to do this bottom-up and some point, it doesn't have to be done like this over and over again, but you need to think about what the actual priorities you want to be spending on, and if you don't do that exercise, you never also have the chance to get rid of some of the outdated or inefficient spending which just becomes, it lives on forever in your budget, because we don't spend any time thinking through that piece of it.

I personally think spending caps at the right level make sense. Now, there is no actual right level, so it's a level that people can live with, but I think the disciplining notion of a cap is useful, I think it should be paralleled on the revenue side, I don't think this is about spending only, it's about spending and revenues. But what worries me is when you have caps on the discretionary side of the budget, because think about how easy it is for a policymaker to come in and say, all we need to do is put in spending caps and live by them.

They haven't actually told you a single thing they going to cut, and that's on a very small portion of the budget, a small portion of the budget that's growing, and they made it sound simple, and basically free. We are just going to put a cap in, and the budget will fix itself. Budgeting is about priorities, it's not tradeoffs.

I think it's important when you put in caps to say what kind of policy changes you would be able to -- you would make to living within those caps and then you want to keep them as a disciplining process that you have to go through your agencies and figure out what's better spending, and what's less important spending. I think an arbitrary cap does more damage than not having one at all.

MR. O'HANLON: Thank you. Bob, do you have a comment on whether you want to get rid of the whole Budget Control Act all together, or could you live with a revision?

MR. HALE: I would keep the caps, whether it's part of the Budget Control Act or another Act. I agree with Maya; you need that disciplining process. The effort to decide, in the case of defense, what you want to spend should indeed be a bottom-up, in fact it is, at least

partially a bottom-up now, I mean, as many of you participated in this process.

The President kind of picks a number at the beginning of the planning process, and revises it late in the planning process that defense, but in between there's a great deal of bottom-up effort. It is threat-based, is the best one can, there's never a simple calculus that says a certain threat yields particular numbers as the arguments go on.

But I think there is a bottom-up process, absolutely important to -- And Mike, your book tries to look at it in broad terms. But in the end, yes, I'd keep the cap because I think that that discipline is important. Whether we need caps, we also at least need more debate side of the discretionary portion of the budget.

I don't know, maybe I can set up Alice here, right, quoting an idea that she had, and I thought it was a very good one, which is, Congress ought to start appropriating for the entitlement portions of the budget. Right now there on automatic pilot and at least that would force them to debate the growing portions of the budget.

So, yes, we need caps, but we need them higher in the case of the discretionary spending and we need to do something analogous in the non-defense -- or in the entitlement portions of the budget.

MR. O'HANLON: Thank you. Alice?

MS. RIVLIN: I think revising the Budget Control Act depends of course what you mean, but revising the Budget Control Act is a mistake because the Act was a mistake. It does not relate to the problem of the whole budget. What you need is to scrap the attention that is being paid to discretionary spending which is, after all, less than a third of the budget. Not that I'm against caps, but the notion of revising the Budget Control Act just keeps the focus on this one-third of the budget which is not where the focus ought to be.

It is not what is driving the long-term increase in debt. I think we all are saying the same thing here, but I would revise the BCA; I would repeal it and replace it with a broader

budget process that forces the Congress to think ahead and several decades ahead about what we are going to do to put Social Security back on a firm basis. That's not a very hard problem but it needs to be done.

What are we going to do to control the cost of Medicare and Medicaid so that we could make a decision every once in a while about what we want to do on them. That is not to say we want to punish old people, we want to think through what is the appropriate amount to spend, and the way to do that is to say, here is what we want to spend and we are going to review it in five years, and if we are off the track then we have a decision to make about what to do.

Similarly, with the tax code and tax expenditure, we spend an enormous amount in the tax code or on things like housing, and other things that we aren't spending terribly well, and we never get a chance to review it. So, I would not just revise the BCA, I would say, repeal it and put back something that deals with entitlements, or so-called mandatory spending, the tax code including tax expenditure, and incidentally, also caps discretionary spending.

MR. O'HANLON: I guess I do have one last follow up for you before going -- and probably some of you would have a similar kind of question, I'm guessing. But I wonder, Alice, if the counter argument that I can think of to what you just said, is that you are now requiring reform in a number of politically contentious areas, and if you link everything together, such that you don't have a new bill until you get agreement on everything. Do we really want to keep the Budget Control Act until a Republican House and Hillary Clinton can agree on tax reform?

Because somebody is going to have to buckle, right? I mean, because the Democrats for a long time had wanted to raise rates at least on the wealthy. Republicans traditionally don't. And so are you setting yourself up for paralysis?

MS. RIVLIN: Well, that's how we got where we are. We've had paralysis for a quite a long time, and paralysis is leading us in the wrong direction. So, sure, I mean probably a total breakdown in any budget consideration of anything would be worse than just reenacting the Budget Control Act, but not much worse.

MR. O'HANLON: Very good. Okay. Well, I think we'll take two questions at a time. Please wait for a microphone and identify yourself when you get it. If you like you can pose the question to one person specifically, or to the panel. I'll start with David Sedney who is right in the middle. I think I saw your hand move. Yes. And about in the seventh row, the very nice tie, in case you have (crosstalk). There are a lot of great ties in the audience.

MR. SEDNEY: Bob, you mentioned OCO for Department of Defense, but of course the Department of State also has about \$14 billion in the OCO request this year. And I wonder if you have any comments about the use of OCO for state as well as well a defense. Then the second question, again, for the entire panel, for you as well. You've recounted the use of OCO before that used to supplement us in the first couple of years in Afghanistan, we just reprogrammed money, but to me it's shown repeatedly, we don't have a mechanism for dealing with unanticipated major contingencies, and then as you've said, the Department of Defense likes to plan ahead, likes to -- many years ahead.

But Afghanistan in 2001, Iraq, all these other things, they don't fit into the budget planning. How do we under your -- Do you have ideas on how we can handle those more effectively than we do now. And finally, one last comment, why don't we just set an automatic budget cuts that have automatic tax increases, if the budget can't be balanced? Thank you.

MR. O'HANLON: And let's do one more, and then we'll go to the panel. Okay, we'll start here in the front row, and then we'll have a second round.

MR. CHECCO: Larry Checco with Accountability Central. I'd like to come at

this from just a little bit of different angle, with revenues. I did a little research recently on the IRS, and they have come out with a report that says, a combination of unreported income, and uncollected income from 2006 to 2010, every year, averages about \$400 billion, that's a huge amount of money when you are talking 30 billion to 50 billion and raising the caps.

A lot of that is because of the unfairness of the tax code, and I think that is something that needs to be addressed, but the other thing that's going to make the problem even more dire, is the fact that the IRS budget is being cut by about 17 percent. So it's not only the perception on fairness it's the perception of unenforced audits. Do you know what I mean?

It's a crap shoot, and the odds are more in your favor every year as long as they keep cutting the IRS budget. So I think if we looked at it from a revenue income position, it might be a little -- we might not be having the situation we are in now.

MR. O'HANLON: Thank you.

MR. CHECCO: Thank you.

MR. O'HANLON: So we'll start with Bob and then just work down the panel.

MR. HALE: So, OCO and state. It's a lot smaller than defense, but as a percentage of state's budget it's much larger. So in some ways it's much more important to say, I think that some of the same issues, I'm less familiar with the details as defense does, in terms of use for non-war needs, but I think the Department of State needs OCO just as the Department needs OCO to be sure that it can finance wartime needs.

And I suspect it would be the same practical problems of getting rid of it, that is the State Department budget would have a great deal of difficulty in absorbing those amounts, so I think we probably need to keep OCO for state. In general, I'd say we are probably spending not enough money on the Department of State, and too much on defense, not enough money in trying to prevent war and negotiating too much getting ready for it and fighting when we have to.



In terms of unanticipated needs, David, I mean, if it really occurs in the middle of a year, you don't have much choice but to move to an emergency supplemental. And Congress is quite good when something serious happens. I mean, 9/11 certainly is an example. They made money available very quickly, days, in that case.

But I think the OCO mechanisms should be maintained. I mean, it's gotten a bad name because it's been misused, but in fact, as I said earlier it has served the Department well, but it has allowed the Department to make sure that the people in combat have the resources they need and that's about to be critical. So I think we should keep OCO for both state and the Department of Defense. Try to restrain its use to just things that are directly related to wartime requirements, and from truly unanticipated needs midterm, middle of the year, will have to use emergency supplemental.

MS. MacGUINEAS: Okay. I'm going to make a quick comment on OCO which may or may not be right. So if it's wrong you need to correct me. But I think given we are spending that could actually legitimately fall into OCO is growing, it may well increase in the coming years, and so there may be more of funds sort of spent on ISIS or other things that could go into OCO. And if that happened, what's interestingly going to actually put some of the pressure on, assuming OCO doesn't grow, it's going to actually put pressure back on to the caps, because a lot of the things that have been pushed into OCO may not be able to. So I just wonder where that's headed.

Contingency budgeting, I think, is a critically important thing, and I'll completely oversimplify, but anybody who runs an organization thinks about these things, you always think about how you want flexibility in your budget so that as either opportunities or threats come along, you can meet them. We still don't do that well enough at all in terms of our budget, and you can see that from fights that are going on right now when it's -- or it's natural disasters, when it's health care threats, when it's national security threats.

We need to do a better and more systematic approach, and put, building into our budget crisis funds, funds for things that you don't expect, emergency funds, that are a certain share of your budget, and you know that these are the likely cost will come, you just don't know where they are. And you have that paid for. Because one of the things that concerns me, again, from my fiscal responsibility mantle is, it shouldn't just be an excuse to not pay for something just because it's important.

This happens all the time. There is a huge emergency, it is critically important that we get funding to it. We should not have a budget that's built so we don't actually pay for it, and borrow it, instead, we should have budgeted resources for those emergencies ahead of time.

And the question about revenue, I think it's an excellent question because when we created the sequester there was a judgment call that was made. And it was, because you are going to include in the sequester across-the-board cuts, both to defense and domestic discretionary, both political sides of the aisle would not want that to happen.

Presumably Republicans would be worked about defense cuts, Democrats worried about domestic discretion, to over-generalize. And so they didn't put revenues into the sequester, I assume because it was too hard a negotiation to include them. I think that was a mistake. We did an internal commission at the Committee for Responsible Federal Budget, a number of years ago, and we had a plan where you would have debt targets. Targets that you have to get to in the budget so that your debt is coming down relative to the economy, and if you fail to get there, there would across-the-board spending cuts and revenue increases.

And it was many of the Republicans who are part of this Commission who said, you need to have the revenue increase, because that's what our side of the aisle is not going to be able to tolerate. That will force us to go to the table, we won't let these sequesters hit. But the lessons of sequesters or triggers is that there's two models. There's the one that you fill it

with really bad policies and you assume that they are so bad, lawmakers won't let them go in place.

Again, oops, we've learned that we don't actually know how to make them bad enough, because we do let them go in place. So, the other possibility is when you build sequesters or triggers, do you actually really build ones that are pretty decent policy so if they went into place. So you think about smart triggers where government didn't act, and the trigger went into place. You had for instance thoughtful reforms to social security that would increase the payroll tax cap, and look at how you change benefits in a progressive way that would help make the system headed back towards solvency.

So if we are going to let those dumb triggers to go in place, it might be better to build smart triggers instead.

MR. O'HANLON: Please?

MS. RIVLIN: I agree with all of that. Back to unforeseen emergencies. I think there has been a bit of progress in budgeting for things like forest fires and floods, that happen, and you ought to be able to budget for a significant contingency fund that allows you to spend when those things happen. And I guess we consider it every once in a while, but avoids, as Maya said, the emergency legislation to which everybody attaches their favorite little spending program and calls it an emergency. But as Bob said, if you have Pearl Harbor, and you have 9/11, you are going to have to do something really special.

On the revenue side, yes, I think if we are going to have sequesters, revenue should be in them, but it comes back to my basic point. We shouldn't be budgeting with gimmicky stuff that forces us to do what we ought to be doing anyway. Namely, here are some big problems, let's sit down together, we the Republicans and we the Democrats, and try to figure out what to do and that's what we are not doing.

We are not talking in bipartisan groups on the Hill and with -- between the Hill

and the White House, on how to solve the problems that we have. Until we start doing that, all of these gimmicks are going to be just unfortunate ways of coping with something we are not doing.

MS. MacGUINEAS: None of us answered the tax cap question as well.

MS. RIVLIN: Oh, let me -- Yes. Go ahead. Absolutely, if the IRS had more money to do audits, we would be collecting more taxes. If HSS had more money to do audits of the Medicare and Medicaid programs, there would be less Medicaid fraud. And that's not trivial either. And it shocks me that doctors are willing to put in false bills, but there are places where they are, and they collect a lot of money, and then nobody goes after them, because the budgets are too constrained. So, yes, we'll enforce rectitude on all fronts.

MR. HALE: Mike, just briefly, and I'll pick up on Alice's point. DoD does have some contingency money appropriated ahead of time of humanitarian disasters, in particular. Had a million dollars and Congress kind of monitors it, it gets spent. They'll add to it, if it doesn't they'll maybe not as appropriate as much, so theirs is inflexibility. And although I never would have said that when I was a DoD Comptroller.

Relatively smaller contingencies in a budget of \$500 billion have been operating via the operating budget of 200 billion, you can move money around to (inaudible) things. Libya is a good example. We spent a couple hundred million dollars in operating costs, we screamed like stuck pigs for supplemental, the White House was totally unwilling to do it, because they didn't want everything attached to it, and we found a way to find the money.

So for smaller items, the size of the Department's budget gives it some flexibility, although one again, I would have disavowed that statement aggressively as a comptroller.

MR. O'HANLON: Let's have a couple more in this round. I'll go to these two gentlemen here.

MR. HURWITZ: Thank you very much. I'm Elliot Hurwitz and it's only been 43 years since I took a PhD in economics. First I want to congratulate Dr. O'Hanlon for his article on foreign affairs. And I'd like to ask any of the panelists about inequality. Inequality has grown significantly in our economy in the last two decades, and if anyone would like to comment on that I would appreciate it.

MR. O'HANLON: Then take another.

MR. HARPER: Thank you. Jon Harper with National Defense Magazine. My question is for Michael and whoever else on the panel wants to weigh in, but based on what the presidential candidates have said so far, what level of defense spending might we expect from a Clinton administration versus a Trump administration, and how might that affect the defense industrial base?

MR. O'HANLON: I guess I'll start, and we can work down the other way this time. Thank you, I should acknowledge, first of all, in the article that I had a coauthor named Dave Petraeus, which was nice to pick up a friend like that. And one of the things that both he and I feel strongly about is that the army has been cut enough. Neither one of us argued in that article or in my monograph for a huge army, but the army today is smaller than it was in the 1990s, and so just in very broad terms, active-duty army was 800,000 or so under Ronald Regan. It was cut to about 0.5 million under the Clinton administration.

And then it went up a bit during the wars of the 2000s, but now it's headed to 450,000 active duty, and about 500,000 they've got in reserve combined. So the whole army together is almost a million but that's still substantially less, obviously, than the Cold War and even a bit less than in the 1990s; that's just one area where we see an argument for modest increases in spending.

By the way, just so you don't think that Petraeus was just trying to beef up his old service, much of the article is about what he, himself coined the phrase that the half

revolution in air power and intelligence, which he really attributes, for a lot of the successes we've had, in many of the commando operations, and other things in recent years.

On the issue of Trump versus Clinton and defense spending; I don't know -- You know, there are a lot of important differences between those two candidates. I'm not sure this is one of them. I don't know that there is any great specificity in either candidate's defense platform. I think both would like to argue that they are improving the military.

Trump has called it a disgrace, I think he has used rhetoric that doesn't really holdup, but in fairness to Trump, and I don't usually use that phrase, but in fairness to Trump it's always -- it's a time-honored tradition to identify specific problems with the military and exaggerate them, or at least really emphasize them in a political campaign, and there can sometimes even be good that comes from that, because you do get people to focus acutely and keenly on the specific shortfalls that always exist, even if you have a, generally, well-resourced military.

So, when I put all that together I would expect either one of those two potential presidents to spend a bit more than we are spending now, to advocate a military a bit larger and more expensive than the one President Obama favors. And therefore, you know, in very broad terms, to be roughly consistent with the number I'm putting out there of a 650 billion a year total national defense budget.

But that's just a guess, because as you know this campaign is not producing quite as many specifics on every policy issue as we sometimes get. And with that I'll turn things to Alice.

MS. RIVLIN: Let me speak to the inequality point, which is an extremely important point, and probably we all feel -- emphasized earlier. We have had, over quite a long period very serious increases in inequality, which is partly at the top, and a lot of attention has been paid there to the 1 percent, which is, I think, a serious overcompensation of high

corporate executives and overcompensation of the financial sector. Some of that's fixable in the tax code. Some of it is quite hard to take, but the much more important problem is what's happening at the bottom.

It's average wages falling behind, and particularly people with the limited skills and education. That's not easy to fix but it's fixable. I mean, we know a lot of things that will help, and we can invest in the skills, and skills of everybody but differentially in those who have low skills and are coming up of either difficult circumstances or have lost jobs and as the economy changes.

And we shouldn't slow down change. I mean, ideally that we can stop the world and get off globalization and do something, I'm not sure what, is defensible. We believe managing change, but that's managing with people or the filing of opportunities for people who are displaced either by trade or by technological change or by anything else that can, given more productive futures.

MS. MacGUINEAS: Okay. First to the question about the candidates; one of the things that we've done at the Committee for Responsible Federal Budget as we've done a whole tally, as to look at all of the candidates' proposals, and how they would affect the national debt. It's called Promises and Price tags, and for anybody who is interested I encourage you to go to our website and look at it.

I won't give away the punch line, but I will just say, we are still looking for somebody who has a plan to deal with the debt, because it doesn't exist yet.

But there are some pretty significant differences between what we found. On the area of defense, there just isn't the specificity at all to be able to figure out what would happen to the budget either -- under either a President Trump or a President Clinton. Trump has made comments that both have said, we need to spend more to strengthen our military, and we need to get rid of waste problems -- or waste in the budget.

Both can be true, actually, and I think it's actually an important thing about budgeting that they are within the files of budgeting, there is probably every area where you should be spending more in some places and less in others. But there have not been any specifics, really, that has allowed us to come up with a score or a cost.

Likewise, what Hillary Clinton has said is that she would like to get rid of the sequester and she would like to pay for it, but she has not said that she would get rid of it, and she has not talked about how she would pay for it. So, we do high, medium and low estimates, and sometimes we assume she would get rid of the sequester, and sometimes we don't, since she hasn't figured out how to pay for it, but said she would need to. Both of those are plans that need -- the details need to be filled out.

On the really important issue of income equality, I think this may turn out to be one of the most -- I do believe it will turn out to be one of the most important issues of our time. And a lot of times when you think about issues, economic issues affecting individuals, there a lot of different things that people talk about. They will talk about poverty, economic mobility, economic security, economic opportunity and income inequality.

And for some reason, income inequality is the one that people get most nervous about. And a lot of times in conversations you'll hear somebody say, no, no, it's not about income inequality, it's about mobility. But I actually think it's gotten bad enough to the point where it really is about income inequality as well as all of those other things. And they each actually have, or as the same as different policies that you need to meet those different objectives.

But one of the problems of income inequality I think is leading to in this country, is that we are supposed to have an economic system that's based on merit, and a political system that's completely separate from your economic situation, and I worry that you are seeing cracks in both of those. We are in a very fast-paced changing economy where it takes



money to make money. Income inequalities are exacerbating and that's one of the problems.

And the second problem is that you are seeing it influence the political sector more than it used to, and in a way, so that you are seeing the consolidation of income and wealth as well as leading to consolidation of power. And so I think these are huge structural issues in our country that go to the core sort of foundations of fairness and how we've built these systems. And I think we are just starting to scratch the surface of what we are going to do about them.

MR. HALE: Well, we certainly don't know what he decided to spend, and Maya and others have said, they haven't been specific, having watched defense budgets now for more than four decades, my sense is the Republicans would start a little higher, and in the debate between threats and concerns about deficit and other spending priorities come down, the Democrats tend to go the other way.

I mean, we saw the -- In the Regan era we saw, I think, that happen, and he started how Congress actually brought that down. His level of spending some -- The Democrats tend to start low, and there's the debate over threats and concerns to come up a bit, and I think you've seen it to some extent in this administration. So I would guess though to end up roughly at similar places. And then I would agree with Mike, given the threats to security right now would be slightly higher than where we are now.

MR. O'HANLON: So let's do another round. I want to make sure I use the back of the room's expertise here as well, but we'll start here in the second row, and then I promise guys in the third and fifth rows I'll come back to you, but yeah, right here, Ben. And then, but I'm still looking for a hand in the back. So, yes, sir, you are the second one this round.

MR. GAFFNEY: I'm Hank Gaffney, 54 years on defense. One thing that I haven't heard, when talking about debt, I read all the Goodwin's, Summer's, et cetera, articles, and of course we are entering a period of secular stagnation, or deep into it, rather, and don't

really know the way out. But at the same time, interest rates like 1.37 percent on bonds, and it looks like it's going to be that way for a long time.

I heard Ben Bernanke in one of these Brookings sessions, a couple of months ago, note that the national debt, the publicly-held debt will increase from 74 percent to 77 percent over the next 10 years. I'm not sure quite what the big problem with debt is.

MR. O'HANLON: And then we'll do one more question.

MR. CLARK: Thanks. Charlie Clark, Reporter with Government Executive. A question for Mr. Hale: Do the Pentagon lobbyists and planners, when they meet with the White House, do they restrict themselves to what the defense budget ought to be? Or, do they take note of the fact that it's linked to the domestic spending and the revenue question, and is it kosher for them to get into that at all?

MR. O'HANLON: Let me start with Maya and then Alice on the debt, and then we'll have Bob take the last question.

MS. MacGUINEAS: Okay. Yes. You are hearing a whole lot right now about interest rate rates are so low, and by God, we should be borrowing a lot more, and no surprise, everybody wants to borrow for things that they actually wanted to borrow for before, even when interest rates were high. So, it's sort of what happens like when there are emergencies, when there are other things. Everybody changes the story for why they want to do what they already wanted to do.

That's not to dismiss this argument, because I think there are some merit to it, and there are some importance to it, but beware people selling free lunches, because there rarely are free lunches when it comes to budgeting an economy, there are smaller that's that we can do actually, we are doing so many dumb things, there's a lot of smarter things we can do, but we cannot fix all our problems without actually tackling the basic tradeoffs that comes from budgeting, if you want to do something, you should pay for it.

What I do think we have on our side, because rates are so low, and again, because we are still the safe haven, is the ability not to worry about our record debt levels today. Not to look at our budget and say, we need to cut spending and raise taxes immediately. But to say, we still have space in our economy to deal with the fact that growth is not what it could and should be, and put in place policies that will help gin up growth now, at the same time that we put in place medium and long-term plan to get our debt back down.

So part of a comprehensive economic growth policy is what things will help grow the economy, one of those things is not borrowing too much. We have seen that -- or there's arguments that are strong and compelling that excessively high levels of debt, slow economic growth, so you want to put your plan -- your economy on a trajectory to get the debt growing slower than the economy, you can do those together, right?

You can put in place more spending, tax cuts if you think that's the right thing in the short term, as long as they are offset over the longer term. I think the bigger issue is, where do you spend money on? Right now, by far, the vast majority of our budget is spent on consumption and not on investment. I think the argument you hear this mainly about infrastructure, let's borrow more for our infrastructure is really an argument of, let's spend more on things that will grow the economy, and infrastructure is particularly desirable because it has long-term growth effects, and short-term job creation. And I think as Alice said, jobs that don't have good wages.

But the problem with argument that rates are so low, we can just borrow, you know, hundreds of billions more on all sorts of investment spending, is we've already started -- we've been borrowing so much for consumption, we've borrowed so much already for things we shouldn't have borrowed for, that we kind of used up a lot of that borrowing space. If we had a budget where we paid for the consumption items that we borrowed for the things that were actual investment; that will be a sensible budget.

But what is not as sensible is to borrow for all your consumption, and then to say, well, the rest is investment so I'm going to borrow for that too. If you've already borrowed for your big spending splurge, you know, then it's hard to say, I have so much room to borrow for college, if you've already borrowed for your major shopping trip for years and years.

The final thing I would just kind of encourage people who think about this issue, the Congressional Budget Office, came out with a really good report that showed spending and infrastructure is a good place to make investments, but spending on infrastructure would help grow the economy more, if it's paid for over a reasonable amount of time.

So it's just like tax cuts don't actually pay for themselves, borrowing for infrastructure doesn't actually pay for itself. You do need to find a way to pay for those things. But because the rates are low, we have a longer time period over which to pay for it.

MS. RIVLIN: Let me address the question of what's wrong with the debt. Why shouldn't we just have lots and lots of debt? I think two things. One is we do have to pay interest on it, and the amount of debt dedicated to debt service is rising rapidly, as Maya said very early, but it's not huge because interest rates at the moment are so low.

I don't think we can count on that forever, and if you think of that, what a very large debt, with even moderate interest rates, as we have experienced in the past, does to your federal budget, you have to pay the interest on the debt. You have to pay it all off the top, and that means that you can't spend as much for all the other things you need to do, including defense.

So that's a big risk. It isn't an imminent risk, but it is definitely a risk. The other thing is, who owns this debt? Way back at the end of World War II we actually had a large debt in relation to our GDP than we have now, but we owed it all to ourselves. Now, the holders of U.S. Government debt are all around the world, and are very heavily -- other governments and financial institutions in other places.

The Chinese, the oil rich countries, and some others, that's a vulnerable position to be in, but I think the problem with the Paul Krugman argument, is that it's a very one-sided argument. I agree with him that we ought to be spending a lot more on investments that will grow the economy, but I think we can do that at the same time that we rein in the longer-run expenditures on consumption primarily for the elderly, does not mean they should have less. But that it shouldn't be growing as fast as it is, and not growing faster than the revenue, and relative to a tax system.

So, (inaudible) is a smart man, but he thinks that you can only concentrate on one thing at a time, and the thing to concentrate on right now is growing the economy and investment. I don't think that's right; I think we have to do both at the same time.

MR. O'HANLON: Before going to Bob, could I follow up and putting on my cap as amateur economist, to ask you -- and I've gotten this, if I'm reading you Alice. Isn't there even a third argument, which is, if we have another economic downturn and we are starting at 75 percent debt, our ability to then get through that downturn without running the risk of losing a lot of foreign investment, and driving the debt up to preposterously high levels, is sacrificed?

MS. RIVLIN: Yes. I mean, look at what happened in 2008, we went into the financial crisis with debt levels that were quite moderate, 35, under 40 percent of our GDP, and just because of the recession we ended up in the 70s. And we can't do that again.

MS. MacGUINEAS: And just to add on to that, because the number that you said was that debt was going to grow to 77 percent in 10 years, it was actually it would grow to 87 percent of GDP over the next 10 years. If we do nothing right now from the nearest CBO numbers, we are on track to borrow \$8.5 trillion over the next 10 years, and the debt will go up more than 10 percent of GDP and that's before you have a lot of unpaid for priorities.

And I think the point that Mike brought in, in addition to Alice's too, is that this is about fiscal flexibility. We were able to deal with 2008 because our debt was in such a healthy

place, but the business cycle as a normal length, we are closer to the next downturn than the last downturn, and we are not in good shape to go forward into that one with our debt where it is already.

MR. O'HANLON: Thank you.

MR. HALE: And Jared Bernstein said consistently and exaggerated the increases in interest rate (crosstalk) is on a nice track --

MS. RIVLIN: Interesting -- Ben Bernanke says that too, not about CBO particularly, but about everybody's projections of interest rates. Interest rate projections have come down. The other piece of good news is that health care spending increases have come down. So, we are not in as dire a situation as we were six years ago, but as Maya says, we have a little more time to fix it. That doesn't mean we should ignore it.

MS. MacGUINEAS: Well, and I think in the newest CBO report, interest rates are projected to be lower, that made the deficit slightly lower, but the sad news was that was a reflection of more dismal projections about the economy going forward. So, lower interest rates isn't necessarily a good thing; it's a good thing, sort of an immediate budget effects, but it's a bad thing when the fact it's reflecting that we don't have enough confidence that we are growing the economy the way we should be.

And regardless of interest rates it's just being prepared to deal with the next economic downturn, is still a very real risk that many people have been identifying recently.

MR. O'HANLON: Bob?

MR. HALE: So Pentagon officials talking to the White House and others about non-defense. First off, please don't use the word lobbyists with Pentagon officials, it's illegal for federal employees, but for the most part to answer your question, I think they restrict themselves to discussion the defense budget. There have been some notable exceptions, Bob Gates spoke out publicly and to Members of Congress about the need for higher budgets in the

State Department, but I think for the most part they restrict themselves.

That doesn't mean there isn't a debate over the broader tradeoffs, the Office of Management and Budget, certainly part of its job is to lay out for the President and senior advisors alternatives that look at both defense and non-defense as well as other federal spending. And of course the President's political advisors would certainly be discussing it. But I think Pentagon officials generally restrict themselves to defense.

MR. O'HANLON: I'm going to add one footnote on that. Ben Bernanke's name has already been mentioned a couple of times today, and last year we held an event in August, with Ben Bernanke, and defense and the economy was the theme. And he and Mark Muro, our colleague in Metropolitan Studies, made the excellent point that for much of the Cold War when defense spending was 6 to 10 percent of GDP, defense almost provided a default national science and investment strategy, because we were putting so much money into research and development, we didn't think of it as trying to build our future domestic economy, per se, and Americans, historically, haven't wanted to have an industrial policy, or to pick winners, or use your favorite phrase, but implicitly we put a lot of money into our long-term economic foundations which spilled over into our domestic economy through the defense sector.

But if defense is only 3 percent of GDP, you are not getting the same magnitude of effects today, and you may have to think harder about whether your science and infrastructure investment strategies therefore deserve more attention and maybe even more resources, directly focused on them because they are not getting it through a spillover over the defense sector the way they were before.

I don't want to put words in that remarks now, per se, but that was the theme of the conversation for a while. So, we'll go back to the front, to the gentleman here in the third row, and then in the fifth, please.

SPEAKER: My name is Eddie Eitches, and I'm a Union Officer. And I think

that the real problem really is getting stuff through Congress, and even when you all talk about infrastructure, there was a story today on NPR about gas consumption being the highest ever, because prices are so low, and no one is willing to increase the gas tax. The Budget Control Act, at least from perspective of inequality, and domestic spending was set up really to project the domestic discretionary budget, and that's why on some level until Congress is responsibility, we still have to have a Budget Control Act.

As to OCO, I mean, I would suggest, as was said earlier, we would want that to be as low as possible to increase the ceiling for the Budget Control Act, to the extent that we still have the Budget Control Act so we can increase domestic discretionary spending.

MR. O'HANLON: Thank you.

SPEAKER: Tom Overly, the National Congress Club. Michael, you've talked before about reforms; and Alice Rivlin as well, and the armed service medical, retirement, accounts like that that would make the Army, the Navy, Air Force, Marines, more efficient. Is there a trigger to induce that? I mean, clearly now we are at the current budget levels, and not in R&D is a product of, perhaps, investing too much in retirement, or other forms of non-efficient returns on capital. What's your preview on that? Thank you.

MR. O'HANLON: Thank you. Maybe we'll take one more since the first was an eloquent comment more than a question. So right here, yes, please.

MR. OLSON: Yes. Tom Olson. A lot of European countries spend a lot less money on education, on defense, and on medical care, and they seem to be -- they seem to have more equality and some would say better lifestyles than America does. So, what would happen if we started to spend a lot less on education, medical care and defense, wouldn't our economy suffer from that?

MR. O'HANLON: I guess we can look down the road, and hopefully we have time for one more round as well. Very briefly and, Bob Hale is going to want to comment, I'm



sure, on your question as well, because he saw a number of proposals by the Pentagon to the Congress, to make modest reforms in personnel accounts, and they didn't go very far, often, like the base closure proposal didn't go very far. And obviously, there are a number of reasons for that.

Some of them very valid, that we realize we were asking a lot of our men and women in uniform, and therefore unless you could really project a commitment to sustain good compensation, people could very easily get nervous that we weren't being fair to them. I think the Obama Administration was very fair to them to be clear, but the politics obviously can be difficult.

You know, on retirement reform in the military, most people here probably know that we have the old-fashioned system of, you do 20 years you get a pretty nice pension, if you do 19.5 years, or less, you get zip. I don't think that's fair. So my first concern about military retirement is equity and fairness more than saving money.

There have been commissions that have looked for ways to save money, recognizing that, you know, retired officers, in particular, they get a pretty nice pension, and many of them come out in their late 40s, or mid-40s and they are very healthy and have good second careers, and there probably is room to rethink some of those officer pensions. But I think the first order of business is to use the savings to give at least a modest 401(k)-like benefit to the person who did eight years and then got out, and may not have as a good of an economic path forward.

So, I become a little more -- reoriented my thinking a little bit on that one. On medical, I do think you probably save a little bit, I think maybe a little higher copayment. But again, Bob has seen the difficulty of getting even modest proposals through the Congress, and in my overall argument, looking at nuclear weapons modernization, would I be a little more parsimonious and economical than the Pentagon, looking at a couple of tactical aircraft

programs where I would make some changes in reforms.

I think if you put a number of these things together, and you get base closures, you might be able, ultimately, to get several billion dollars a year in savings that are sustainable and, you know, stay at that level. You are going to do very, very well, ever to approach 10 billion in the aggregate of all of those reforms; which is why I still favor a modest real increase in the defense budget.

MS. RIVLIN: I would subscribe to the importance of the pension reform, and also I think the savings and improved care to be had in reforms to the dependent's health care and retiree health care. Look, when it comes to the question about other -- about countries, because I think it's complicated, yes, much of Europe spends a lot less on defense, that's because they've got us to defend them, and they know it.

So, I don't think that one counts. They do spend less per person on health care, and that -- but they spend more, in general, on social services, children's allowances, early-childhood education and social supports, which is part of why, I think, they have less inequality. And why do we spend so much on health care, and never seem to be able to have a satisfactory system? It's for a lot of different reasons, we have this complex system of very high administrative costs, and we compensate our health professionals extremely well.

Especially the specialists; and we use more specialists. And there are other reasons, but it's a complicated question, and just saying, well, if we spent less we have more equality, but would it hurt our economy, I'm not clear one way or the other.

MR. HALE: So, I think that actually I'd come at the reforms in a different way, I think this administration has had some success, as past ones have. For example, Congress did pass a modest reform in the military retirement system that provides a 401(k)-like provision for those with less than 20 and slightly reduces the pensions, or modestly reduces the pensions for those with 20 and more.

But a lot of other things, restructuring, co-pay as in pharmacy, for example, so that you get people to use generic and mail order, and Congress went further and actually mandated the use of mail order, and I could go through a number of lists. DoD needs to continue that, they owe it to themselves because they need the money, they owe it to the public because there are options for further reform, and hopefully Congress will cooperate.

And you know, the history if you keep trying, they will, I think we'll get back legislation eventually, even though they desperately don't want it, because of the job effects, I think eventually they are running out of reasons to say no, and I think we'll see it at the next President and Secretary of Defense budget. So, yes, there has been some reform, and it needs to continue.

MR. O'HANLON: Okay. One last round, and then we'll wrap up. So we'll go to the gentleman in the far back who has been waiting patiently, and then my women friends in the room are really going to make me call only on men, this is not going to go over well. So, even though I've got some very distinguished women, obviously, with me on the panel, so we've got back here, and I guess going once, going twice, we'll go to these two gentlemen up here with really quick questions, and then we'll be answering everybody's questions.

SPEAKER: One really technical question, when I think on debt structuring in the United States, we did away with the 30-year bond, or Treasury did some years ago, with interest rates this low, would it be a good thing to bring that back? And my second question is, who is everybody's Secretary of Defense Nominee for the two candidates?

MR. HALE: I'll let you answer that one.

SPEAKER: David Borowitz. I have a very quick question; it's been mentioned several times that we need to revise the tax system. Can we get some specifics?

MR. RYPINSKI: I'm Jack Rypinski, unaffiliated. I was just wondering how unified should the budget be especially with entitlements, and should there be a lot more in

larger contingency funds? And also like with infrastructure, or with DoD, if you want to put an investment in place, you have downstream maintenance and replacements costs that aren't immediately budgeted.

MR. O'HANLON: Bob, do you want to start and then we'll just work down?

MR. HALE: Well, in terms of -- I'm going to pass on the next Secretary of Defense, let's get through the election. In terms of the unification of the budget, I mean, I'll give the same answer I did before. I think the Departments probably need to be arguing for their own. The President needs to hear alternative views, of what the departments need, and -- but he or she has got to depend on places like the office of management and budget to bring alternative views, or the balance.

And I think, within reason, that process works, you know. Alice headed OMB so she can take exception if she wants but -- And certainly in the case of defense and non-defense, there were lots that OMB was free with their thoughts, on alternatives for the President and I think that's as it should be.

MS. MacGUINEAS: I'm going to address your tax question. So, where to start? There are so many things we could do to reform our tax code, but the way I think about tax reform is the basic parameters of broaden the base, lower the rate, and along with lowering the rate take some of that money to close the budget deficit. But the tax base is Swiss cheese. We have so many expenditures, credits, exclusions, deductions, and they are incredibly popular.

It's really easy to talk about them and say, oh yes, we need to broaden the tax base, but then when you say to somebody, that means the home mortgage interest deductions. Oh, no, it's not so popular anymore. But there is over what's significantly over a trillion dollars in the lost revenue, a year. That is a lot of money that we could make up by getting rid of a bunch of those tax breaks that, they get no oversight. They are very regressive; they pay

people to do things they'd be doing anyhow. They are not structured in ways that are thoughtful and we never go back and look over them.

So, I would do as much as possible to broaden that base. It's very difficult to do. I came up with -- Marty Feldstein and I, and Dan Feenberg, came up with a plan that said, if you can't go through them one by one and really make reforms, at least you could think about capping them, so you limit how much in tax breaks, relative to your income, somebody could take every year. That way you wouldn't have to pick the winners or the losers of the tax breaks, but we would say, they can only be X amount of your income, or X amount in terms of dollars.

I am not a huge fan of the corporate income tax. I think it doesn't work very well in a globalized economy where capital is so mobile. So, while I think there a lot of things we have to do to reform the corporate income tax, I'm actually more interested in thinking about big replacement taxes, and new revenue sources that this country needs.

The one I've always loved is the progressive consumption tax, I think taxing more of what you don't want instead of what you do want is a smart thing. I think consumption taxes can make sense, but they are very regressive. So, progressive consumption taxes, which are difficult to administer and create, but are very desirable in terms of design. And I'm certainly a fan of the carbon tax; I think it's long overdue in this country.

So I think there a lot of places we could go. The goal should be to increase our competitiveness, the efficiency of the tax code, taxing things that we want to be taxing and to raise revenue.

MS. RIVLIN: I agree with that. Let me just underline a couple of points. One is, yes, the tax base is Swiss cheese, and there are a few egregious things that ought to be fixed, like calling the income of hedge fund managers that carried interest that somehow it's something that -- some kind of expense that shouldn't be taxed. That's ridiculous, and it would help a little bit on the inequality problem.

But there are actually only a few deductions that make a lot of difference, deductions, exclusions; one of them Maya has already mentioned, is the home mortgage deduction, and it is a deduction, not a credit, so that the higher your income, and the larger your mortgage, the more it benefits you. Now that's ridiculous. We just went through a period in which we grossly overbilled high-end housing, in part because we subsidize it so much to the tax code.

It doesn't mean we shouldn't encourage home ownership, but you could convert the home mortgage deduction to a credit against tax, and design it so that it wasn't quite so costly, and it benefited middle-income people more and high-income people less. And they have to phase it in and all that stuff but that's a very good idea. The other big one is the exclusion of your employers' health benefits from your income, which is a big incentive to say, I want generous health insurance from my employer because it's not taxed.

I'd rather have that than wages. And that's very unfortunate, and because it leads to overconsumption of health care, and the people who benefit from that are the same people, high earners and particularly people who work for big corporations. So, gradually phasing out that exclusion would make a lot of sense.

MR. O'HANLON: And as I thank my co-panelists or the speakers today, and thank all of you for being here and for your excellent questions, I'll briefly answer this last question about who might be Secretary of Defense.

MS. RIVLIN: Are you a candidate?

MR. O'HANLON: No. But I'm going to come to somebody else on this stage who might be, or at least who I think should be, but I don't know who Donald Trump would choose, and so I won't go there. But I do think that people, and in seriousness people talk a lot about Undersecretary of Defense, Michèle Flournoy, as a person who would be the first woman Secretary of Defense in American history. I'll just take this moment since I was asked, to say I

believe she would be an excellent choice.

I think she's a very serious choice. Ash Carter, I think, is doing a good job where he is, so if Michéle Flournoy were not the choice of Mrs. Clinton, then Secretary Clinton, President Clinton, might choose to stay with the current situation and if she doesn't line up with either of those two choices, I think the guy to my far right here today would be a pretty darn good choice, himself.

MR. HALE: Spare me.

MR. O'HANLON: So thank you all for being here. (Applause)

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