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FLIRTING WITH DISASTER: SOLVING THE FEDERAL DEBT CRISIS

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED THIRTEENTH CONGRESS

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CONTENTS

Opening Statements of Members

Hon. Kevin Brady, Chairman, a U.S. Representative from Texas 1
Hon. Dan Coats, a U.S. Senator from Indiana 1
Hon. Amy Klobuchar, Vice Chair, a U.S. Senator from Minnesota 2

Witnesses

Hon. Judd Gregg, former Chairman of the U.S. Senate Budget Committee, Rye Beach, NH 5
Hon. Alice Rivlin, Senior Fellow, Brookings Institution, Washington, DC 8
Hon. Doug Holtz-Eakin, President, Action Forum, Washington, DC 9
Dr. Simon Johnson, Ronald A. Kurtz Professor of Entrepreneurship, Sloan School of Management, Massachusetts Institute of Technology, Senior Fellow, Peterson Institute for International Economics, Cambridge, MA and Washington, DC 11

Submissions for the Record

Prepared statement of Senator Coats 36
Chart titled "Total Federal Revenues and Outlays" 38
Chart titled "Long-Term Spending vs. Revenue Outlook" 39
Chart titled "Fiscal Consolidations" 40
Prepared statement of Hon. Judd Gregg 41
Prepared statement of Hon. Alice Rivlin 47
Prepared statement of Hon. Doug Holtz-Eakin 65
Prepared statement of Dr. Simon Johnson 76
Article titled "Windows of Opportunity Closing" by Judd Gregg submitted by Representative Erik Paulsen 83

FLIRTING WITH DISASTER: SOLVING THE FEDERAL DEBT CRISIS

THURSDAY, MARCH 14, 2013

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to call, at 9:59 a.m. in Room G–50 of the Dirksen Senate Office Building, the Honorable Kevin Brady, Chairman, presiding.

Representatives present: Brady, Campbell, Amash, Paulsen, Cummings, and Delaney.

Senators present: Klobuchar, Murphy, and Coats.

Staff present: Corey Astill, Gail Cohen, Connie Foster, Colleen Healy, Mike Lee, Patrick Miller, and Robert O'Quinn.

OPENING STATEMENT OF HON. KEVIN BRADY, CHAIRMAN, A U.S. REPRESENTATIVE FROM TEXAS

Chairman Brady. Well, good morning everyone. Welcome to the Joint Economic Committee's second hearing of the 113th Session of Congress. We have a great panel of witnesses today.

I would like to yield for the opening statement to the Senior Senator, Republican Senator, Senator Dan Coats. Thank you.

OPENING STATEMENT OF HON. DAN COATS, A U.S. SENATOR FROM INDIANA

Senator Coats. Mr. Chairman, thank you. I want to thank you and Vice Chair Klobuchar for holding this hearing on a subject I think of vital importance to the future of our Nation's economy, and in fact our national security: the ever-growing debt deficit.

Our spending addiction in Washington has led to the point where we now face the prospect of record deficits as far as the eye can see. The fact is that Congress and the Executive Branch have failed to address the debt crisis effectively. Temporary stopgap measures solve little, if anything; they simply put off the inevitable day of reckoning.

Eventually we will reach a point where investors either stop buying our debt or insist on higher interest rates to account for the greater risk, potentially triggering a crisis of confidence.

Many experts also believe that our failure to seriously grapple with our ballooning national debt is already having a significant detrimental impact on economic growth.

We all know, or at least we ought to know, that our current path is unsustainable. Academics, economists, business leaders, the various bipartisan committees that have been formed, Republicans

and Democrats, all basically repeat the same thing: Unless we make the tough spending choices that we have been avoiding for years, we are going to face a debt-induced meltdown. It is only a matter of time, and the clock is ticking.

The plain fact is, in order to make a real impact on the deficit and the federal debt, we need to go big and we need to go bold. And the time to do that is now. We need to incorporate a combination of spending discipline with mandatory structural reform of our mandatory programs, and growth-oriented comprehensive tax reform.

Those three elements, in my opinion, are absolutely necessary for us to achieve what we need to achieve.

Today's hearing presents us with an opportunity to find common ground in tackling these difficult issues. I look forward to the testimony of our witnesses. I want to welcome my former colleague and friend, Senator Judd Gregg, who has had a distinguished career as Chairman of the Budget Committee, as someone looked to in the Congress as an expert on these issues. We are pleased to have him with us.

Dr. Rivlin, I have learned about your Hoosier roots this morning to go with your many other great credentials in terms of service to this country and being such an outstanding voice currently dealing with this issue.

Doug Holtz-Eakin, Dr. Holtz-Eakin, thank you very much for your continued work.

And Simon, Dr. Johnson, we thank you also and we look forward to your testimony this morning, and your guidance and support and help in terms of how we can address this critical issue, because I think the time is now to do it.

Mr. Chairman, thank you.

[The prepared statement of Senator Coats appears in the Submissions for the Record on page 36.]

Chairman Brady. Thank you, Senator.

Vice Chair Klobuchar.

OPENING STATEMENT OF HON. AMY KLOBUCHAR, VICE CHAIR, A U.S. SENATOR FROM MINNESOTA

Vice Chair Klobuchar. Thank you very much, Mr. Chairman. And I wanted to also thank you for our last hearing. I think it had a very good tone and a very good start to our year with the Joint Economic Committee, which really can be a sounding board and a place where we can come together and talk about in a very timely way the proposals that are before the Congress.

I did want to mention that Rachel and her family from Minnesota are the only ones from my Minnesota Breakfast that took me up on my invitation to come to this hearing. I see them back there this morning, and they are a reminder that we are talking about real families and real jobs and the future of our country here as we listen to these four great experts that appear before us.

I see this as a time of great opportunity. Our economy has stabilized. The unemployment rate was the best it's been in years. Just this past month, the housing market is coming back. In my state, the unemployment rate is down to 5.6 percent, and we are seeing great expansion in exports in many of our industries.

But what I see as holding us back right now is the inconsistency that we have seen in tax policy. It is the fact that companies are not able to know what is going to happen next with their investments, and the fact that we have not gotten a clear path to bring this debt down.

We have made some progress, as we all know, with, first of all, the bipartisan Simpson-Bowles Commission, which I think did some very good work. I was one of 14 Democratic Senators that made very clear that we were not going to vote for a debt ceiling increase until we got that Debt Commission in place.

I would have liked to see it statutory, something Senator Gregg and Senator Conrad worked so hard to do, but it is what it is. And it was not just a report that collected dust on a shelf; it actually gave us some ideas as to the Rivlin-Domenici work and a lot of the other work done by people right before us on this panel.

But what has happened since the report has been released? We have achieved nearly $2.7 trillion in deficit reduction over a 10-year window. The goal of many is to at least get to $4 trillion reduction in 10 years.

The Senate proposal right now that is being marked up in the Budget Committee proposed by Senator Murray is another $2 trillion in reductions, and I think it is something worth looking at. And I know the House also has its own proposal.

Again, I see this as an opportunity. There is a sense of urgency—Senator Coats and I were together last night at a meeting—a sense of urgency that we have not had for awhile. Some of it is caused by the effects of sequestration, which I think most people would agree is not the exact way we want to handle this.

Although we want to see some spending cuts, I also think that we can do this in a balanced way with a combination of revenue and spending cuts. We simply cannot afford to have a repeat of what happened last December with the brinkmanship. As much as I loved spending a very romantic New Year's Eve with Harry Reid on my left and Mitch McConnell on my right, every woman's dream, at the stroke of midnight, I believe there is a much better way that we can go forward here. And I hope it is going to start next week with keeping the government running with the Continuing Resolution, as it looks like it is, and hopefully putting some flexibility in with the sequestration, and then moving on to a major deal which the President has made clear that he wants, and I think you are hearing a lot of noise from Democrats and Republicans that they would like to see a balanced approach.

So far, what we have seen of the debt reduction, which I just mentioned, the $2.7 trillion, 80 percent has come from spending cuts. And it comes out to a ratio of about 4-to-1 spending cuts to revenue. That is actually a different ratio and higher on the spending cut end than that proposed by both the Simpson-Bowles and the Domenici-Rivlin proposal.

So I think there is room to continue to look at revenue, whether it is closing loopholes, whether it is looking at things like, I will mention as being from a state that produces a lot of biofuels, that the ethanol tax credit expired. That saved billions and billions of dollars. The oil company subsidies are still in place, that's $38 billion, over the next 10 years.

Some of the tax breaks that are in place that incentivize companies to ship jobs overseas, that's $200 million. The home mortgage deduction, very important to me and to middle-class families, if you cap it at $500,000 in value on a home—so if you buy a $1 million home, you still get it up to $500,000, that saves $41 billion. Buffett rule, $53 billion.

I think there are ways that we could add revenue into this mix without setting the recovery on its back and still get the spending cuts in place, and do them at a level that is different than the sequestration level.

There are also proposals for Medicare. One I would throw out there is negotiation of prescription drug prices. That saves $240 billion in savings right there, as well as some of the additional delivery system reform that can be made.

So I am looking forward to what our experts have to say. But overall, I feel a sense of urgency. I also feel a sense of incredible opportunity as I see that America is making things again and exporting to the world, and we have to do our jobs in Washington to allow our workers and our companies to move forward. And that means reducing our debt in a reasonable way.

Thank you very much. Thank you, Mr. Chairman.

Chairman Brady. Thank you, Vice Chair.

The title of today's hearing is "Flirting with Disaster: Solving The Federal Debt Crisis." And we have a distinguished panel who took time from their busy lives as national leaders to be with us today.

I am honored to introduce former Senator Judd Gregg to our hearing today. Senator Gregg has served in his home State of New Hampshire as a Governor, as a U.S. Representative, and most recently a three-term U.S. Senator, thus making him the first elected official in the history of New Hampshire to achieve all three offices.

During his tenure at the Senate, Senator Gregg was the Chairman of the Budget Committee and is a respected leader on fiscal policy, budgetary reform, and financial regulation. He was the original author of the Conrad-Gregg legislation, which was the impetus for Simpson-Bowles; a leader of the Wyden-Gregg Legislation for Bipartisan Tax Reform; and participated in several bipartisan efforts to reform entitlements in health care.

Senator Gregg served on the National Commission on Fiscal Responsibility and Reform, along with another of today's witnesses, Dr. Alice Rivlin, where they worked toward finding a bipartisan solution to our Nation's debt crisis.

I am honored to introduce Dr. Alice Rivlin. She is currently a Senior Fellow in the Economic Studies Program at the Brookings Institution, and a Visiting Professor at the Public Policy Institute at Georgetown.

She has previously served as Vice Chair of the Board of Governors of the Federal Reserve System and Director of the Office of Management and Budget during the first Clinton Administration. Dr. Rivlin was also the first Director of the Congressional Budget Office after its establishment in 1975.

In 2010, President Obama named Dr. Rivlin to the National Commission on Fiscal Responsibility and Reform, and there she

worked alongside Senator Gregg to develop what is known as the Simpson-Bowles Plan.

I would like to welcome Douglas Holtz-Eakin to our hearing today. Dr. Holtz-Eakin is currently the President of the American Action Forum in Washington, D.C. He has developed a distinguished record as an academic and policy advisor. Most recently he served as Commissioner on the Financial Crisis Inquiry Commission, the Director of Domestic and Economic Policy for the McCain Presidential Campaign. He served as Director of the Congressional Budget Office, assisting Congress in tax cuts and Social Security reform.

He also worked to bring economic stability as the Chief Economist at the Council of Economic Advisers during the aftermath of the September 11th terrorist attacks. He has also taught economics at Columbia University, and became the Chair of the Department of Economics at Syracuse before being called to serve as Director of the CBO.

Welcome.

I would like to welcome also Dr. Simon Johnson to our hearing. He is currently Professor at the Sloan School of Management at MIT, and a Senior Fellow at the Peterson Institute for International Economics. He is also a member of the Congressional Budget Office's Panel of Economic Advisers, a research associate at the National Bureau of Economic Research, and a Research Fellow at the Center for Economic Policy Research.

He is the founder of the Economics Blog, "The Baseline Scenario" and is a contributor to Project Syndicate. Prior to his current positions, he was Chief Economist at the International Monetary Fund and taught economics at Duke University's School of Business.

Dr. Johnson brings a unique international perspective to our Nation's debt crisis.

With that, I would like to introduce Senator Gregg for your testimony. Senator.

STATEMENT OF HON. JUDD GREGG, FORMER CHAIRMAN OF THE U.S. SENATE BUDGET COMMITTEE, RYE BEACH, NH

Senator Gregg. [inaudible, microphone off.]

Chairman Brady. If you could hit that microphone? And I know you said that before.

Senator Gregg. I did it. And this is an entirely new experience. [Laughter.]

Chairman Brady. It's good to see how the other side lives.

Senator Gregg. A pleasurable one. Thank you for inviting me, and it is great to be here with this wonderful panel with my close friend, Dan Coats, who I served with for I've forgotten how many years but it's been quite a few.

It is a pleasure to address the panel, and thank you for having me participate on this critical issue, which is critical to our Nation's future and prosperity.

I think it was defined in some ways, and probably best by the Foreign Minister of Australia. He was speaking to Bob Zoellick, who was former head of the World Bank, and Bob is fond of telling the story about how he said to him just a few months ago, the Foreign Minister of Australia, he said to him: You know, the United

States is one debt deal away from leading the entire world out of economic doldrums.

And that is absolutely true. When you look at our country, so much is going right in this Nation right now, we are in my opinion on the verge of a massive economic expansion due to our shift in energy primarily, but also because we are still the place where great ideas come from, whether a Facebook or Apple, or in my region of the country health care.

We have got huge amounts of liquidity, and we still have an extraordinarily entrepreneurial people ready to go out and take risks and create jobs. And the one thing that is holding us back is our fiscal policy, and the fact that we have this very serious and legitimate concern about the sustainability of our debt.

The Simpson-Bowles Commission, which Dr. Rivlin and I served on, came to the conclusion that on our present path this Nation goes bankrupt. That is essentially the fact. Senator Coats referred to that fact. And we have to figure out how to straighten this out. We have to figure out how to do the deal that straightens this out.

And I congratulate the Congress and the President for having made some progress—not as much as needs to be made, but there has been progress. And there is a long way to go. And the question is: How do we get to the next step? And what should the goal be?

Well under Simpson-Bowles we suggested that the goal should be to stabilize the debt at 70 percent of GDP or less. That is a very high number. Historically, our debt since the end of World War II has averaged about 35 percent of GDP. To stabilize it at 70 percent of GDP probably does not put us on a health path, but it keeps us going.

However, if we do not stabilize it at 70 percent of GDP, we are obviously going to go to regions which are now being tested by countries like Greece, and Spain, and Italy of over 100 percent, which means inevitably, as Senator Coats referred to, the markets will lose confidence in our currency and our cost of debt will jump dramatically and we will have a fiscal crisis.

Because think of it. If you look at the budget today, we spend about $250 billion on interest, $250 to $300 billion. If we were paying historic interest rates, we would be paying about $600 billion. $600 billion. We could not handle that. But we will pay much more than historic interest rates, we will pay a lot more if the markets lose confidence in our currency.

So we have got to get this problem under control. We are now—you now are struggling with the sequester issue, which is an attempt to address the question. And the issue becomes how should we address the question?

Well, clearly the sequester should be replaced by targeted action in the area of entitlement reform—and I know members of this panel are going to talk about ways you can do that, and I am a hundred percent for that. And the important thing about entitlement reform is that that is where the money is, so to say. You know, Willy Sutton used to say he robbed banks because that's where the money is. Well, if you are looking at the deficit and the debt, the thing that is driving it is our massive cost of entitlements.

So we have to reform them. And another important thing about entitlement reform is it is not tomorrow that it has to occur. We have got 5 years, 10 years, 15 years that we can work our way into policies which change and bend the cost curve over the long run. And, which do it in a way which does not impact the recipients of entitlements in any significant way, but rather makes those programs like Medicare, Medicaid, and Social Security solvent.

So that is one step we have to take. We also need tax reform, which has been referred to here. The Wyden-Coats proposal is an approach to that. But how do you structure this action? I've been thinking about this, and this is where I want to end, how do you get this done?

Well, I think actually how do you get the deal done? Well, I think actually the Speaker of the House has laid out a pathway. He said: Let the Senate do it.

[Laughter.]

Well that is an interesting idea, and it is not a bad idea, by the way, with Presidential leadership. And I congratulate the President for in the last few weeks stepping forward and saying I'm going to get into the room on this issue.

So I believe you can set up a structure here where you use the Senate as a sounding board, because there is a working center in the Senate, with Presidential leadership, where you develop a package which can actually address this issue substantively. And then take that package to the House as the Speaker has suggested, rather than have the House initiate it and take it to the Senate.

I would caution this: The budget process is probably not going to be that process, because the budget process is inherently partisan. That is the nature of the budget process. It may set the goalposts at both ends of the field, but when budgets reach the Floor, especially in the Senate, they end up with a lot of votes being cast to lock in opinions and positions which are not very flexible.

And to get this done, you are going to have to have compromise—compromise on both sides of the aisle.

Two other points, structural points, which have to be part of any major deal:

One is that you have to target the size of the government. Simpson-Bowles set it at 21 percent, or 21.3 percent. That sets everything in motion, spending restraint and revenues. And secondly, any changes in entitlement must be subject to a 67-vote point of order before they can be reversed. Otherwise, you cannot lock them down for future Congresses.

Thank you, very much.

[The prepared statement of Hon. Judd Gregg appears in the Submissions for the Record on page 41.]

Chairman Brady. Thank you, Senator. And to be clear, letting the Senate go first was not our first option.

[Laughter.]

But we are where we are. So we understand. Dr. Rivlin, you are recognized.

STATEMENT OF HON. ALICE RIVLIN, PH.D., SENIOR FELLOW, BROOKINGS INSTITUTION, WASHINGTON, DC

Dr. Rivlin. Thank you, Mr. Chairman, and Vice Chair Klobuchar. I agree with everything my colleague, Senator Gregg, has said.

Let me begin by saying, this hearing is entitled "Flirting with Disaster: Solving the Debt Crisis." Let me respectfully suggest an alternative title: "Growing the Economy and Stabilizing the Debt."

I make that suggestion because I think prosperity requires bipartisan cooperation to achieve two goals at once.

One is faster economic growth and lower unemployment; and the other is a sustainable long-run budget plan that will halt the projected rise in the debt-to-GDP ratio and put it on a downward trajectory.

It is not a choice. These two goals reinforce each other. Stabilizing and reducing future debt does not require immediate austerity. On the contrary, excessive budgetary austerity in a still slowly recovering economy undermines both goals, but it does require a firm plan enacted soon to halt the rising debt/GDP ratio and reduce it over coming decades.

And putting the budget on a sustainable path and reducing the debt will require bipartisan agreement on entitlement reform that slows the growth of health care spending and puts Social Security on a firm foundation for future retirees, and does that soon.

It will also require raising additional revenue through comprehensive tax reform. I believe that enough discretionary spending restraint has already been accomplished—more than we suggested in Simpson-Bowles and Domenici-Rivlin. And that is why I think the sequester is really bad policy and should be replaced with entitlement reform and tax reform.

I think we all know the reasons why entitlement reform is imperative. The combination of the demographics and health care spending growth makes Medicare and Medicaid and Social Security the drivers of unsustainable federal spending in future years.

Social Security should be the easiest to reform, because it involves only money without the complexity of health care delivery, and it requires fairly minor, well-understood tweaks in benefits and revenues to regain fully funded status.

Enactment of a bipartisan Social Security reform now would reassure current workers, demonstrate that our democracy works to solve problems before they reach crisis proportions, and contribute to stabilizing the debt.

We cannot afford to wait on Social Security, whether we do it separately, as Senator Durbin is suggesting, or as part of the budget reform. Workers who will be retiring in 2033 are already in their mid-40s. We owe it to them to ensure that they can plan for Social Security as they reach retirement age.

Medicare raises more complex issues, but even there a bipartisan compromise to slow Medicare growth without depriving seniors of needed health care is surely possible.

American health care is expensive compared to that of other developed nations, and its quality is uneven. And part of the reason is our fee-for-service reimbursement system, which encourages pro-

viders to deliver more services but does not reward efficiency or quality.

We can convert Medicare by changing the incentives to a more efficient system. There are two possible approaches to improving the performance of health providers along those lines, and one is to change the incentives in traditional Medicare toward rewarding quality and not quantity. And I'm for that.

The other is to foster competition among health plans on a regulated exchange or market. We need to try both. And we do not need to do it by replacing Medicare with a premium-support model. We could introduce the competitive element more smoothly by ensuring that Medicare Advantage Plans compete in a more transparent marketplace, and improve incentives to lower costs.

Finally, there is the question of tax reform. Both the Commissions that I served on had base-broadening and rate-lowering plans, and we must do something like that. But let me reiterate, in closing, that both growth and debt stabilization are important, and they should be done simultaneously.

Thank you.

[The prepared statement of Hon. Alice Rivlin appears in the Submissions for the Record on page 47.]

Chairman Brady. Thank you, Dr. Rivlin. Dr. Holtz-Eakin.

STATEMENT OF HON. DOUGLAS HOLTZ-EAKIN, PH.D., PRESIDENT OF THE AMERICAN ACTION FORUM, WASHINGTON, DC

Dr. Holtz-Eakin. Mr. Chairman, Vice Chair Klobuchar, and Members of the Committee:

Thank you for the privilege of being here today. Let me just say at the outset, it is an honor to be on this panel with my former boss, Senator Gregg; and the founding Director of the CBO; and a gentleman who teaches at an institution where I couldn't get into graduate school.

[Laughter.]

So I am honored. No hearing is complete without a chart from CBO, so why don't we just start with the facts and remind ourselves that the most recent projections from CBO are actually quite daunting, in my view.

They say that on auto-pilot, we accumulate $7 trillion in additional deficits over the next 10 years. And even more troubling, the trajectory is one where any illusory near-term improvement reverses about 2015 or 2016 and we see the sharp spiral upwards in the deficit and, importantly, in the debt in the hands of the public. That is part one of the bad news that comes out of the CBO this February.

The second part is that underneath that is an economic projection which shows slow growth in 2013, about 1.4 percent, and a marked writedown in the long-term growth potential of the U.S. economy of about 2.2 percent over the long term. And I at least believe that those are not unrelated phenomenon, the debt and the growth.

There is literature largely attributed to the scholars Ken Rogoff and Carmen Reinhart that suggests that countries that have gross debt, a slightly different measure of debt, over 90 percent of GDP pay a penalty in the form of slower growth.

The CBO projection says that the United States, which currently has federal debt in excess of the size of GDP, over 100 percent of GDP, will remain at that level over the next 10 years and thus will continuously pay a penalty in the form of slower economic growth of about 1 percentage point a year as the estimate. That translates into all sorts of things that are very close to home: a million jobs, slower income growth for American families, and a recipe for stagnation that the United States has the great opportunity to avoid, and should.

And I concur with what Senator Gregg said at the outset. We have the capacity to do much better, and this is the break on our growth. Now what would it take to fix that?

To get us out of the danger zone, to get us below 90 percent of GDP requires something north of $4 trillion. And while I applaud the efforts of the Congress and the Administration in past years, I think it is not time to rest on our laurels. Our problems are significant and remain large.

And smaller measures, those which merely stabilize the debt/GDP ratio in my view are in fact flirting with disaster. They say that should interest rates spike, as the Senator mentioned, or if economic growth does not turn out to be as robust as we might hope, the debt is not stabilized. It moves north, and it moves north quickly and runs the risk of generating a loss of confidence in the United States in world capital markets.

And so I think that we cannot merely stop at trying to stabilize something which will at the end of the 10 years of stabilization go north again anyway. It is time to be aggressive. I think that is not inconsistent with more rapid economic growth. I think it is a foundation for more rapid economic growth.

Now how do you do that? We can have a longer discussion, but sadly we are not the first country with the dual problems of bad growth and big debt. It has happened before. And if you look around the globe, there is no perfect solution. But to the extent that a playbook emerges, it contains some components that have come up today. One should undertake a comprehensive tax reform and use that as the foundation for better economic growth and financing the government. And one should use the spending side to control the growth of debt. But not all spending is created equal.

The core functions of government—national security, infrastructure, basic research, education—need to be preserved in this process. And instead the focus should be on cutting transfer programs, which in the United States means dealing with the entitlement programs, the Social Securities, Medicares, Medicaids that Dr. Rivlin mentioned.

I will point out—and I say this lovingly and gently—that the current strategy, which is to sharply raise taxes at the beginning of the year without reform, and to slash discretionary spending as far as the eye can see, is 180 degrees opposite from what we should be doing. Other than that, we're doing fine.

But this is an opportunity. I agree with that. We do have the ability to reform especially Social Security, which you can reform any of a number of ways and send the signal that we know how to deal with our problems, take some red ink out of our future and deal with the debt, and that would be a great first step toward ad-

dressing what I think is the paramount issue of our time. Thank you.

[The prepared statement of Hon. Douglas Holtz-Eakin appears in the Submissions for the Record on page 65.]

Chairman Brady. Thank you, Doctor. Dr. Johnson.

STATEMENT OF SIMON JOHNSON, PH.D., RONALD A. KURTZ PROFESSOR OF ENTREPRENEURSHIP, SLOAN SCHOOL OF MANAGEMENT, MIT AND SENIOR FELLOW, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS, CAMBRIDGE, MA, AND WASHINGTON, DC

Dr. Johnson. Thank you, Mr. Chairman, and thank you, Members of the Committee, for the invitation.

I agree with some of the points that have been made by my distinguished colleagues. I think this is an opportunity. I would recommend drawing on the international experience to which you mentioned at the beginning, Mr. Brady, my work with the International Monetary Fund, my work on economic crises over 25 years around the world. I think you should aim for more debt reduction over the next two decades than even Senator Gregg suggested. I think a target debt/GDP by 2030 in the range of 40 to 50 percent makes sense because you do not know what is going to happen in a country like the United States with opposition in the world and needs to have what the IMF likes to call fiscal space; the ability to take on challenges both domestic, for example, in the case of another financial crisis, or international. We do not know what is going to come our way.

So I think you should seize this moment. I agree also with my colleagues, there are some things on the table, including Social Security reform, that are achievable.

I think unfortunately we are perhaps inadvertently already in a fiscal disaster. Senator Coats is of course correct, there is one kind of fiscal disaster that involves people not being willing to buy your debt, interest rates go up, the currency collapses, and you go hand-in-cap to the International Monetary Fund.

That is not our reality today, obviously. I doubt that is what we face over the next decade or two. I think we are much more likely to get what Dr. Holtz-Eakin referred to, which is a confused combination of policies that emerge from our distinguished and wonderful Constitutional system—don't get me wrong—but the way it is playing out is a big unfortunate. And particularly undermining again what Dr. Holtz-Eakin said, which is the essential public goods that the government provides, research and development, for example, defense, the readiness of our military forces also an essential part of maintaining prosperity.

I think what we should do, and what I hope you will do, is assess the programs that we have, both in terms of their pro-growth impact—which is the returns on much of that; I read the CBO literature carefully; returns are impressive; and not just Social Security but also the social insurance we provide through the health care system.

I think we would all agree is the big sticking point. I do not think the issue there, by the way, is Medicare per se, although obviously the numbers Dr. Holtz-Eakin showed are correct, if you

want to look out 50, 70 years, it is all about health care—but it is health care spending. Not just the government-provided part of health care; it is the entire health care spending, the drivers of health care spending.

If you take those out of the budget and shift them onto firms, or onto families, that is a big competitive disadvantage to the American companies. I talk a lot to CFOs and CEOs about tax reform, corporate tax reform, and I think there are some sensible ideas out there, but I always impress on them that in 20 years the big driver of loss of competitiveness in the United States is going to be our health care system.

I think I have recommended to many of you and to your staff before, but I will recommend again, Statistical Table 12–A in the IMF's Fiscal Monetary publication—all the good stuff in the IMF papers is at the back in the statistical tables—12–A compares projections of health care spending and the impacts on budget looking out 20, 30, 40 years across the countries we are going to be competing with.

This is where we really look bad. We have to get a handle on that. And you have to decide, with an aging population, with improvements in medical technology, with an inability or a great difficulty of running private insurance schemes for people who are in their 80s and 90s—that was the experience before Medicare; that will be the experience if Medicare ends—how much social insurance did you want to provide?

As Senator Gregg said, what is the size of government as a percent of GDP that is consistent with that? I am afraid, in the numbers that I look at—again drawing on the CBO—21 percent of GDP is low, looking out over 3, 4 decades, because of what is happening to the nature of our population.

This of course brings us to the most difficult issue, which is revenue. I do not see how you could balance the budget in 10 years without increasing revenue; I read Mr. Ryan's budget proposal; I don't think that is a good idea. I don't think that is conducive with continued growth, let alone accelerating growth for the kind of prosperity we are hoping for.

I think the specifics that Senator Klobuchar put on the table, the specifics that are in the Senate budget proposal that Senator Murray presented yesterday, should absolutely be part of the agenda. And I hope they are part of the conversation. And I hope that they are part of the compromise.

As Senator Gregg said, we are one good debt deal away from a great period—another great period of American prosperity.

Thank you, very much.

[The prepared statement of Simon Johnson appears in the Submissions for the Record on page 76.]

Chairman Brady. Thank you, Dr. Johnson.

I have to confess, I hope to live my entire life without ever reading the IMF's Statistical Table 12–A——

[Laughter.]

Just let me be clear there.

The testimony was excellent. I had a chance to read it earlier this week. It was very insightful, and I think that Dr. Holtz-Eakin's point on the growth gap of the current recovery, and the

prospect—not reality—the prospect of potential GDP falling permanently over the long haul is a concern of the Joint Economic Committee. And together in a bipartisan way we are going to look at ways we can close that, both on the fiscal and monetary side as we go forward.

I have a couple of questions that I would like to run through quickly. None of them are "got'cha" questions. We rarely have this opportunity with you four experts here.

So on making Social Security and Medicare solvent over the long term what is critical to all of this is timing. How soon should Congress and the President act to assure investors, to avoid a potential downgrade, to really address our financial situation.

Senator? Each of you? How soon should we act on reaching the solution?

Senator Gregg. I think you have to act to show seriousness of purpose as soon as possible. And when you do that, I think some of the growth issue is going to be addressed, because I think the markets will respond, as well the investment community to that sort of action.

Chairman Brady. I agree.

Senator Gregg. That means setting up a definable process for getting to closure on an agreement on entitlement spending and on revenues.

Chairman Brady. You're thinking this year, or next?

Senator Gregg. Oh, this year. Before June, hopefully.

Chairman Brady. This year. Thank you. Dr. Rivlin.

Dr. Rivlin. For Social Security, I would say 10 years ago. But this year will do.

[Laughter.]

We have known about this problem for a long time and have not fixed it.

On Medicare, I would say right now. We are still learning about how to improve the efficiency of health care, but I think the accumulating knowledge gives us enough to go on right now.

Chairman Brady. Got it. Dr. Holtz-Eakin.

Dr. Holtz-Eakin. I do not have a clever way to impart a greater sense of urgency. I mean, the sooner the better. Let's face it. And there are some demographic mechanics that make this an imperative.

If you think about changing Social Security for example, and there has been the convention of grandfathering those who are of a certain age or younger, 55 or younger, I am now 55. I am the trailing edge of the Baby Boomer generation. If you grandfather me, you grandfather the problem. And so the bumper sticker should be: Get Doug Holtz-Eakin, and get him this year.

[Laughter.]

Chairman Brady. We'll get that printed up. And you're talking about timing of this year, act now, Federal Government, ten years. Got it. Dr. Johnson.

Dr. Johnson. Well for the record, I would like to note that Dr. Rivlin has actually been warning us all about this since the 1980s. So it is 30 years ago. And I think you should act immediately.

Why not establish a bipartisan commission along the lines of that established by President Reagan and Congress in the 1980s?

Specifically I would suggest to deal with Social Security. That is surely not an easy problem, but a problem where the two sides seem better able to come together.

On health care and on Medicare, that seems more difficult. And I agree with showing purpose would be very helpful, and if there are ways to take that away from the intensity of the partisan discussion that would be extremely constructive, but I am not sure I have seen that on the table yet.

Chairman Brady. And I agree. We ought to be—we could save Social Security this afternoon. The truth is, we all know what needs to be done.

Along those lines, there is talk about changing CPI and Social Security and some means-testings for Medicare. Are those two reforms alone enough to make those programs solvent over the long term? Or do we need to do more?

Senator.

Senator Gregg. Those would go an inordinate amount of the way, but you should also adjust the BIN points, obviously, which is means-testing, and probably the age. Interestingly, in Simpson-Bowles we decided to take Social Security out of the deficit debate and the debt debate and deal with it separately. I understand Senator Durbin is suggesting that also.

There are only four or five moving parts and they can be adjusted so quickly, if you can get the politics to agree to do it, and that is why doing it independent of the debt issue is I think so important to take the politics out of the issue.

In my view, if the Durbin approach was followed, it should be—that Commission should report by Easter and vote on it before the summer recession.

Chairman Brady. Dr. Rivlin.

Dr. Rivlin. You need to do more. The chained CPI is a technical change which would improve the estimate of inflation in the benefits. But it need not be done in a way that hurts low-income or especially old people.

In the Domenici-Rivlin plan, we did go for chained CPI but we also bumped up the minimum benefit, and the benefit at age 85, so that you don't disadvantage people who live a long time. I am increasingly for that (laughing).

And on Medicare, yes, you need to do both. And I am not a fan of raising the age at this point, actually.

Chairman Brady. Got it. Dr. Holtz-Eakin.

Dr. Holtz-Eakin. I would concur. I think you need to do more, no question.

On Social Security, I think it is very important to remember that you are really not doing more. The current plan is that the program will remain actuarially solvent. And the way we are going to do it is we will have essentially a Social Security sequester, an across-the-board cut at 25 percent.

That is a disgraceful way to run a pension program. And so it is not about doing more to Social Security; it is about doing something more intelligent, and doing it now so that people can plan.

On Medicare, I think the number one priority should be to put it on a budget. Right now the gap between payroll taxes and premiums going in and spending going out is $300 billion a year. It

is a third of our trillion dollar deficit. It's got 10,000 new beneficiaries every day.

So you have to send the signal to the provider in the beneficiary community that there is a certain amount of money. Go do something smart with it.

Chairman Brady. Thank you. Dr. Johnson.

Dr. Johnson. Congressman, as you know on Social Security we did not index the maximum wage subject to Social Security. I would go back to what worked for Ronald Reagan. If it worked for Ronald Reagan, it should work for us today.

I think you should look at pension age. But you have to be very careful that, while longevity on average has increased substantially in American males aged 65 who are expected to live 3 years longer than was the case in 1970, that is not true across the entire wage distribution. Manual workers, lower income people, have not—lower income males have not had an increase in longevity. And I think you want to be very careful about balancing those adjustments in that framework.

And just changing the CPI does not do that for you. And on Medicare——

Chairman Brady. If I may, Doctor, I apologize. We are going to let you step forward in just a second. I want to turn this over to Vice Chair Klobuchar. But a quick question: A lot of talk about tax increases again. We have had a first round, about $1 trillion in the President's new health care law, a half a dozen of which have kicked in this year.

Republicans and Democrats agreed on $600 billion plus at the beginning of this year's fiscal agreement. Absent fundamental tax reform, does anyone on the panel want to argue that another round of tax increases will be helpful to the struggling economy?

[No response.]

Vice Chair.

Vice Chair Klobuchar. Did you want them to answer?

Chairman Brady. I got the answer I wanted, so——

[Laughter.]

It's like Moneyball. Hang up. Vice Chair.

Vice Chair Klobuchar. Okay. We can go back and answer some of those later. I just wanted to get some common ground here. It appears as though all of our witnesses agree that sequestration is not the best solution right now. Is that correct?

And that——

Senator Gregg. If I could just annotate that, it is a better solution than doing nothing.

Vice Chair Klobuchar. Okay. Thank you. But we could do this in a more nuanced way in terms of where the spending cuts hit. All right.

And then also that we should be doing something to keep Social Security solvent, and that there are many ways to do that. I am not going to get into those details. I thought that the Chairman did a good job of getting some of those answers, but that that could be done in a way that the savings would go back into Social Security as Senator Durbin has suggested. And there are many ways that we could do that.

I guess my question is: As we go forward here—two. One is the substance of how we should do this balance with the spending cuts and revenue. And the second is something Senator Gregg raised about how we get this done procedurally. Because I completely share in this view that we are one debt deal away from being able to not only expand but to also tackle some of these other issues that we have to work on in Congress, whether it is immigration reform, or whether it is some of the workforce training issues that we are confronting right now.

I mentioned about how with the spending cuts when you include sequester about 80 percent enacted since 2011 has been spending cuts for the debt reduction. And that is not consistent with where the Rivlin-Domenici or Simpson-Bowles were. What balance do you think would be best?

I think I'll just ask you two that question, first, starting with Dr. Rivlin and then Senator Gregg. With the remaining amount to get to at least the $4 trillion.

Dr. Rivlin. I think it works out to roughly half and half. I am not sure how we add up the numbers exactly, but we need substantial increases in revenue from tax reform.

I would not give a positive answer to the Chairman's previous question. We have lots of room to reduce spending in the Tax Code. And we need to do that. And it will produce more revenue in a progressive way over time, and we need to do that.

Vice Chair Klobuchar. And you see that as, if we do it in the right way—and I threw a few ideas out there, and obviously you have some as well—that we could do that, in addition to making some spending cuts, and then some of the entitlement reforms that you suggested, that we could do that in a way that would not set us back, which I think is important to everyone up here.

Dr. Rivlin. I think we have done enough cutting in discretionary spending as a total. You can reallocate it toward more growth-producing things, and perhaps over time away from defense and toward domestic, but I would not say more discretionary cuts were the priority at all.

I think the stabilization of the debt depends on reforming the entitlements.

Vice Chair Klobuchar. Senator Gregg.

Senator Gregg. I think in order to get Republican buy-in on further revenues you are going to have to do policy changes in entitlement accounts that bend the curves in the outyear in a very substantial way, and make it clear that those accounts are sustainable.

And once you do that, you can get a buy-in I believe from many Republicans on the issue of taxes through tax reform. And affixing a number to that, well Simpson-Bowles was 3-to-1 theoretically; the President has been 2-to-1. My view is that it is the policy that should drive this, and the key policy is entitlement reform that bends the outyear curve.

Vice Chair Klobuchar. And I know, coming from New Hampshire you have seen some of the Dartmouth studies on the delivery system reform, and the Mayo Model, and those things that I hope would be a part of this.

Senator Gregg. Absolutely. I don't think you can get there without doing what Dr. Rivlin referred to, which is you shift from a utilization system to a qualities and outcome system. You start to capitate the costs so that your people are—the system is reimbursed on the individual, as versus on the procedure.

And that is going to get you where you want to go. And interestingly enough, there is a massive amount of activity occurring in the marketplace right now. It is occurring in your state at the Mayo Clinic. It is occurring in Utah. It is occurring in Pittsburgh. It is occurring at Baylor. To try to accomplish that.

Vice Chair Klobuchar. And then on this process issue, which we talked about some when I saw you yesterday, when you talked about the Senate going first—and I appreciated the Chairman's not being even snarky about the Senate——

[Laughter.]

One of my favorite former House Members, Congressman Oberstar, always used to joke that all they ever do in the Senate is confirm judges and ratify treaties. And I said we haven't even been confirming enough judges lately.

But I think things have greatly improved in the last year in terms of getting some of the mid-sized bills through the Senate, whether it's the Farm bill, the Patent Reform bill, the Transportation bill. And as you noted, I see a lot of hope with this group in the middle that is working on the debt.

And I wondered if you could talk about, if we pass a budget in the House and Senate, as I think is happening as we speak, then how we procedurally get to this place where we are in a conference committee, but then we allow the Senate to work with the President, who clearly is now very engaged in this issue to come up with some kind of deal that could be the true compromise you are talking about.

Senator Gregg. Well, Dr. Holtz-Eakin would probably have a view on this, but I think that the budget process is probably the wrong vehicle. Because when it hits the floor, you are going to see all sorts of hot-button amendments which are going to put people in positions of voting and formalizing their position in a way which is not constructive to compromise.

And then, assuming you could even get a conference, the vehicle for getting something significant done would be reconciliation. And you cannot do significant health care reform through reconciliation, in my opinion, even though Obamacare was allegedly done that way, but you really can't do it. Because your reconciliation inherently produces, instead of getting a horse you get a camel. In fact, a multi-backed camel, because of the Byrd Rule, which goes through and makes public policy—just eviscerates good public policy, the Byrd Rule does.

So I think you are going to need a new vehicle. You are going to need the President leading the group. The President has got to be in the room, and he's got to bring everybody together and people have to agree on what they need to do, and then you develop the vehicle to accomplish the goal.

Vice Chair Klobuchar. And I know a lot of this was just what we saw in the papers, but I have seen numbers on this. It seemed to me at the end of the year that the President and Speaker

Boehner in their proposals were not that far apart in terms of optimism for trying to get this done. Has anyone looked at those?

Dr. Rivlin.

Dr. Rivlin. Yes, I think they were very close. And the importance of having the President help broker the deal I think is very high.

Vice Chair Klobuchar. Okay. Do you want to add something here, Dr. Holtz-Eakin, Dr. Johnson, generally to my questions?

Dr. Holtz-Eakin. "Close" does not count until you get a signature, so there is a lot of work to be done. And I think this discussion underestimates the importance of getting the White House involved. And the White House needs to exercise a degree of leadership that has been missing. Only the White House can put out a proposal that says this is a national issue. Only the President is elected by all the people. And his missing in action on this over the past years has stopped the Super Committee from being successful. That was a lot of good work. It was done with great intention. It did not get across the finish line.

Things only get across the finish line with White House leadership, and that is an imperative at this moment.

Vice Chair Klobuchar. Dr. Johnson.

Dr. Johnson. Senator, we spend about 17, 18 percent of GDP on health care. The British spend 8 percent. Our government spends 8 percent. We get about the same outcomes as the British. I am not recommending their system, but I think using the pricing, using the power to negotiate the cost of prescription medicines in this context, and other assertions of the market power to the government when you are buying that much health care, is essential if you want to control the costs.

Vice Chair Klobuchar. Okay. Very good. Well I appreciate all your comments. Senator Murphy is going to fill in for me, I believe, for awhile. I am going to be over at Judiciary, but I thank you for what you have done. And I do see some common ground here, and I see some common ground up here, especially in our really strong belief that we have to get this done and get moving on this, and the time for games is over.

So thank you very much.

Chairman Brady. Thank you, Vice Chair.

Senator Coats.

Senator Coats. Thank you, Mr. Chairman.

This is a fascinating discussion. I really appreciate the comments from all of you, particularly from Senator Gregg and supported by others, in not just the "what." We have been debating what should we do for a long time now, and we have had numerous commissions and committees and so forth and so on. But also the "how."

Because if time is of the essence—and I think there is unanimous agreement that we need to do this now; we run into political difficulties really once we get past July and people start focusing on the next election in 2014 and Members are looking to what do I need to do to protect myself from the onslaught of why did you do this? In primaries and so forth. And then you're into a Presidential cycle.

And so that pushes real opportunities like this one into about 2017, which I think most of you would conclude is way too late. So

this is the time. This is the time to do it. And so focusing on the how do we get it done, I appreciate Senator Gregg's contributions in that regard.

The question, Dr. Rivlin you said in your testimony, you said that comprehensive tax reform and the other reforms that needed to be made to stabilize the debt need to be simultaneous. How do we make these simultaneous?

And I guess I would ask that question of Senator Gregg because you were talking about the how. If we all agree that they need to be simultaneous, there is a lot of talk about comprehensive tax reform. That takes a year at least, or it is going to take more than a year and so forth. And right now they are separated in terms of what we need to do now.

So it is discretionary spending and mandatory now, tax reform later. So, Senator Gregg, do you have a suggestion as to how we push tax reform as simultaneously with this other effort?

Senator Gregg. I think you need an agreement that is a hybrid reconciliation bill—it probably shouldn't even be called "reconciliation"—but that essentially outlines in very specific language as to what the committees of jurisdiction must do, and the time frame they must do it, so that they are reporting back on comprehensive tax reform and entitlement reforms essentially on a time track that is very visible, very transparent, and everybody knows it has to be done.

And failure to do that needs, in my opinion, a fallback position which forces action. Maybe you just take Simpson-Bowles and use it as your fallback position, but something like that so that you end up with—or Wyden-Coats would actually be an excellent fallback position on the tax side—so that you get something done, and you have a clear pathway, and it is subject to certain rule requirements which force it to be done.

Senator Coats. Appreciate the plug for Wyden-Coats. Anybody else want to comment on that? I think the question pretty much has been answered.

Let me go to a second. Michael Boskin and Austan Goolsbee testified before us just a few weeks ago. We were talking about balance, and that question has come up.

Dr. Boskin said, well, there are two different types of balance. The President basically defines balance in more of a socioeconomic way. That is, fairness requires 50 percent taxes/50 percent spending. He said, but economic balance doesn't fit that model at all.

The ratio, if you want to achieve the kind of growth that is necessary and put us on the right path and deal with this debt/deficit issue, that balance needs to be, he said, a 5-to-1 or 6-to-1 ratio. Austan Goolsbee said, well, at least it ought to be a 3-to-1 ratio, and not lower than that.

Well currently we are either at a 2-to-1 with the political system essentially right now saying, no, no, it needs to be 1-to-1. What are your thoughts on that? Let me start at the other end with Dr. Johnson

Dr. Johnson. Well on this point I think, Senator, I disagree with Dr. Boskin. I think that—again, you have to go program by program. And I understand this format, we do not have a lot of

time to do this. I did write a book on this topic—I understand Mr. Brady might not want to read that, either——

[Laughter.]

But if you go through what does the government do, and I think to the point, to your point which is a very good point, what gets in the way of growth? What is good for growth? What gets in the way of growth? And what is part of a reasonable, fairly basic compared to other countries, but reasonable system of social insurance that we have developed over the decades?

When I look at it that way from the bottom up, I come to the position that, while there are important changes to be made on the spending side, some of which you have already done, some of which Senator Klobuchar talked about, I lean much more towards overall revenue side. The Bush tax cuts took about $4 trillion—looking over the decade, the basis that we usually do—about $4 trillion in revenue out of the system.

I would seek—and I was trying to dissent on your earlier question, Chairman Brady—I would seek to replace that—not immediately; not with immediate austerity, so don't please misquote me on that—but over two decades I would like us to get back to the kind of revenue trajectory we were on prior to the Bush tax cuts.

And then we have to look, going beyond the two decades, at Dr. Holtz-Eakin's chart and say, okay, what is happening to the demographics of our population, to the income-earning capabilities, to the kind of health care that people want and hope to get when they are 95 in 2050.

Senator Coats. Thank you. Dr. Holtz-Eakin, did you want to comment on that?

Dr. Holtz-Eakin. Economic balance says revenues match expenditures. And that is the only balance that has any sort of substantive foundation. The rest is politics. And all these ratios are politics.

Everyone in this town loves to talk about taxes. You know, I used to have hair and they were still talking about taxes back then. All we talk about is taxes. The fundamental decisions the government makes is to spend the money.

So I would go back to what Senator Gregg said. Design the programs. Decide how large the government is going to be. Do a tax reform to finance it so that the budget balances, which is something we have—a discipline we have lost in the Federal Government that needs to be restored.

Senator Coats. Dr. Rivlin.

Dr. Rivlin. I do not see any magic in Mike Boskin's assertion that there is a specific ratio of taxes that is most conducive to growth. I think we can make our tax system a lot more conducive to growth by getting rid of the spending in the Tax Code, or reducing it, and still raise considerably more revenue in a more pro-growth way.

And I do not think it is realistic that a country with our values can absorb half-again as many seniors over the next 10 years by reducing their benefits in order to get to balance that way. It is just not realistic.

Senator Coats. My time has expired. But a quick comment, Senator Gregg.

Senator Gregg. Well I think the appropriate way to approach this is to set the size of the government as a percent of GDP. Once you have done that, everything else falls from that. Historically it has been 19.8 percent. We have had a massive expansion of retirees. Simpson-Bowles agreed to go to 21½. Somewhere between those two numbers is probably the right number.

Senator Coats. Thank you. Thank you, Mr. Chairman.

Chairman Brady. Thank you. Representative Cummings.

Representative Cummings. Thank you very much.

First of all, Dr. Johnson, thank you for referring to entitlements as "social insurance" because that is exactly what it is. Sometimes I think we forget that.

And one of my concerns, Dr. Rivlin and Senator Gregg, is that when we are dealing with entitlements, changing CPI, raising the age, things of that nature, at what point do we get where people simply are placed in a position, say, for example, where they have got to take a voucher out to get insurance, and they are not able to afford it, at what point does it become counterproductive?

In other words, folks are not able to get the health care that they need. Or they are falling into a situation where, like many African American males, they die before they even get Social Security. They die. They're dead.

Or say if you change the age with regard to Medicare, needing Medicare when you cannot get it, or whatever. And I am just wondering. You know, Mark Zandy came here awhile back, and one of the things he said was the thing that drives Medicare costs of course is the cost of medicine.

And he said that he felt that there was some sign that the cost of medicine in Medicare, the inflation in Medicare costs, was at least beginning to stabilize. And he said that he believed that it was in part due to the Affordable Care Act.

And I am just wondering, you know, how do you all see that? I am really concerned, because a lot of my constituents, all they have is Social Security and Medicare. That's it. They don't have any pensions. They don't have any savings. Many of them have been victims of the Recession, lost their homes, lost all their equity.

And there are a lot of people like that. It sounds like you all took it into consideration with the Domenici-Rivlin report where you looked at older folks and you needed to have different formulas and that kind of thing, but I am just curious. I know there is a lot there, but I would like for you to address that.

And finally, how important is it, Senator Gregg—and I agree that we need to separate Social Security from all of the other things, the other social insurance type matters that we are dealing with.

Dr. Rivlin. I think you are raising absolutely the right considerations. When you do either Social Security reform or Medicare reform, you have to look at who is impacted by it.

But I believe you can put Social Security back on a firm foundation without making it harder for low-income, low earners. As I said, in Domenici-Rivlin we actually increased the benefits, made them better off in the reforms that we put in place.

And then you have to do some compensatory things at the high end, a little less generous benefits for people with higher income.

In Medicare, I believe that we can make our system more efficient by rewarding quality and outcomes across the board in getting away from fee-for-service in a way that does not hurt anybody in the near-term.

Now maybe in a few decades we will have to worry about rationing care, but we have such an inefficient health system that we can squeeze out some of this duplication and excess spending on health without hurting patients. I truly believe that.

Representative Cummings. Senator Gregg.

Senator Gregg. I think Dr. Rivlin is absolutely correct on both points, and Simpson-Bowles did the same thing that Domenici-Rivlin did, which was to actually increase benefits to single women over 85, and low-income individuals.

And I actually believe if you do Medicare reform correctly, you actually get a better system at a lower cost, which is exactly what we need, which is what Dr. Johnson's point is. You can't have our health care system absorbing so much of the economy.

Do you separate out Social Security from the others? I think you should. My concern about doing it too quickly, although it should be done immediately, without moving the other part of the equation is it is going to take a lot of air out of the balloon once you fix Social Security to do the rest of the problems. Even though substantively it does not impact our long-term debt dramatically to fix Social Security, it psychologically would. And I am not sure how much energy would remain to do the Medicare fixes and the tax reform if you did Social Security unilaterally and on a separate track.

But it can be done and should be done because it is doable.

Representative Cummings. Dr. Johnson.

Dr. Johnson. Just one point on the age of Medicare, which has not really come up yet but obviously it is in the mix. I think that is one you should worry about a great deal, Congressman. If you move that from 65 to 67, that is going to impact exactly the groups that you are worried about.

This is a very hard risk to insure. It is going to be expensive if they do it by themselves. The companies are not going to want to take on that risk. That is an additional hit to American competitiveness, by the way.

So moving the age of Medicare—I agree of course with making the system run better with controlling the price of prescription drugs. It is going to be essential. I would not advise increasing the age at which people qualify for Medicare.

Dr. Holtz-Eakin. Could I just add a footnote to that? I mean in the aftermath of the Affordable Care Act we have exchanges which have subsidies for low-income Americans of any age. And presumably they would provide quality insurance.

And so the notion that somehow changing Medicare is going to leave people outside the safety net is just not true.

Representative Cummings. Well unfortunately, and as I close, there's a proposal to get rid of the Affordable Care Act. So we have to take that into consideration, too—I don't think it's going anywhere, but thank you very much.

Chairman Brady. Thank you, sir. Representative Paulsen.

Representative Paulsen. Thank you, Mr. Chairman. A great hearing and some similar, common themes actually from all of you that have taken the time to testify today.

There is a question right now, knowing that debt is an issue and it is a drag on our economy, I want to dive into this a little bit deeper with Dr. Holtz-Eakin. But it absolutely is an issue.

The question is sort of how urgent is it of an issue right now? I know that Senator Gregg had a column recently in The Hill from February 25th how the window of opportunity is closing. Mr. Chairman, if I could just submit that for the record, that would be great.

[The article titled "Windows of Opportunity Closing" appears in the Submissions for the Record on page 83.]

Representative Paulsen. And also, mention the President just yesterday in an interview, he actually said that we don't have an immediate crisis in terms of debt. He said for the next 10 years we are in a sustainable place.

That is kind of an interesting comment to me. I think CBO kind of backs up, we've got a serious growth gap now. There's a drag on the economy in terms of having a report that says debt held by the public is projected to remain historically high relative to the size of the economy for the next decade.

And already such a debt would increase the risk of fiscal crisis during which investors would lose so much confidence in the government's ability to manage its budget that the government would be unable to borrow at affordable rates.

And what is clear, there is this correlation between high levels of government debt and slower growth. And, Dr. Holtz-Eakin, you did not touch on it in your oral testimony but in the written testimony you did talk about this one percentage point penalty.

Can you just talk a little bit real quick on that based on your testimony regarding that one percentage point penalty, when you're at a certain level above 90 percent of debt, and the drag on the economy. And I should ask you this, too. Do CBO's projections of employment and income growth, do they fully account for the loss imposed by slower economic growth, in your view?

Dr. Holtz-Eakin. Well the empirical finding—this is not my finding, but this is out of the literature—is that highly indebted countries over 90 percent of GDP gross debt, is the measure of debt used here, pay about a one percentage point—that's the median estimate—penalty in growth per year.

And often the question is sort of how does this happen miraculously that we grow more slowly? But if you think about where we are with dramatic levels of debt, over 100 percent of GDP, the projections that show an unsustainable trajectory, if you do not make a commitment to control spending, then what have you said to the world?

You have said, well, if you want to locate here, or hire here, expand here, then you face two futures. Future number one is where we do not do anything. We do not fix the spending. We do not fix anything. And we hit a financial crisis—it is not exactly a pro-growth policy.

Or future number two is one where we try to tax our way out of this problem. And that is utterly detrimental to growth, particu-

larly given where we are. And so it is not surprising to me that heavily indebted countries, particularly when you get out in the tail where we're headed, have bad growth problems. It is a terrible signal to send.

And so that, I think, merits some fixing. Now I just want to say, there is this counter-argument that says, no, no, no, we want to spend now, stimulus. You know, I'm not a big fan of that, but there is not as big a conflict as you might think, because if we do the right reforms that everyone here has talked about, go where the money is in the mandatory spending, you can take the pressure off the discretionary side. You do not have to have discretionary austerity, and we can do a lot better.

Representative Paulsen. Yes, I would concur. That would be the right direction. But let me just ask this question for everyone on the panel real quick, because it seems to be almost universal, almost universal in the testimony that in these bipartisan plans we need part of the focus to be on fixing the Tax Code. Right? And economists call for lowering rates, especially the corporate rate, broadening the base, eliminating loopholes.

However, at times around the Capitol, most of the discussion has been centered around on boosting revenue as a part of the existing Code from reforms. Should the discussion about higher revenues focus on reforming the Tax Code to spur higher economic growth levels? Or should it be more focused on getting more revenues out of the existing Tax Code?

Senator Gregg, and we will just go right down.

Senator Gregg. I think Simpson-Bowles got it right on this point. We reduced deductions and exemptions so that we generated $1.1 trillion of revenue every year. We took $1 trillion of that and reduced rates. So the rates under Simpson-Bowles were 9, 15, and 23 percent on the individual side. We took $100 billion and reduced debt.

So over the 10 years of the Simpson-Bowles $4 trillion number, $1 trillion came out of revenue and $4 trillion came out of—was represented as being savings. But the purpose of the tax reform in Simpson-Bowles was to create a Tax Code which would energize massive growth where people would invest for the purposes of return rather than for the purposes of avoiding taxes. And as a result, you would not only get the static number of $100 billion of more revenue coming into the Treasury, but you would get an actual dynamic number of much more than that.

Representative Paulsen. Dr. Rivlin.

Dr. Rivlin. I think fortunately it is not a choice. If we do the right thing on reforming the Tax Code, we will have more revenues and we need them.

Dr. Holtz-Eakin. I agree with that. I think one of the lessons here is something the Senator said earlier, and I want to emphasize it. If you lose sight of good policy in the effort to get the right numbers, this is a bad exercise.

A tax reform is good policy. It will cause growth. It will also generate revenues.

Dr. Johnson. Congressman, I think you should be bolder on taxes: Value Added Tax. Shift from taxing income to taxing spending. Actually, there is a lot of agreement across the political spec-

trum that that is the right general idea. But there is very little agreement that you want to go anywhere near VAT.

And just, if I could add to what Dr. Holtz-Eakin said about the debt and how much time do we have, which is a great question, we have no idea. It depends not just on us, it depends on the world. We are the world's number one reserve currency.

If the world shifts its portfolio preferences away from the dollar towards, I don't know, the Euro, the Renminbi, some other currency, other countries would like that role, then the time frame is much shorter. If we stay number one in this specific reserve currency sense indefinitely because the Chinese blow up their financial system, or the Europeans fail to turn around their sovereign debt, then we have a lot more time.

Nobody knows the answer to that question. We should start now. We should not act precipitously or in a way that damages ourselves. We should set ourselves on a course where people say, yes, the Americans have got their fiscal affairs in order looking out two, three decades.

Thank you.

Representative Paulsen. Thank you.

Chairman Brady. Great. Thank you. Representative Delaney.

Representative Delaney. Thank you, Mr. Chairman. And thank you for organizing such a terrific panel. I thought the comments really have been exceptional, and I think, Senator Gregg, you started us off in almost a pitch perfect tone. So I appreciate that very much.

I have—and Dr. Holtz-Eakin, I think that you framed the urgency of dealing with this appropriately. And it seems to me we almost have some room to over-correct for the problem. Because if we act now, as we know we don't have to affect current beneficiaries, or even people who are close to being current beneficiaries, and if we almost can over-correct for the problem, if we have more economic growth than we expect, if we can actually bend the cost curve in health care, or these other demographic shifts, it gives us tremendous flexibility.

And it kind of tees up a question, or two questions I would like to ask each member of the panel.

The first is: It seems to me our debt issue should be broken into almost two categories. The debt that we have in years, call it 1 to 10, which we tend to talk a lot about because our budget framing is in 10 years; and then the debt crisis that occurs in years 11 through 20, or post-11, if you will. And it seems to me, at least in my own opinion, it is the second component that is of most concern and will lead to all the negative consequences everyone has talked about.

It will also crowd out every other priority in our budget. There will be an interest rate crisis, as Dr. Johnson referenced. We do not know when it will happen. The only thing we know for sure is we will not be able to predict when it happens.

So my question is: If we were able to successfully deal with the future debt concerns that are depicted on the graph so well, do we have more flexibility to deal with years 1 through 10? In other words, is really the problem here the debt in the out-years, as opposed to the debt in the short years? Because it seems to me we

do need to be making investments in our economy not so much for the purposes of pure economic stimulus, but for the purposes of preparing a broader number of Americans for a new world that is fundamentally changed because of globalization and technology. And a broad number of Americans have been left behind because of that, and a narrow number of Americans have benefitted because of that. Not because they did anything wrong, it is just the way the cards have been dealt.

So it feels to me like we do need to make investments. And if we could deal with the long-tail risk on our debt, our ability to manage, it seems to me, the debt in the next 10 years is dramatically enhanced and we are in a much better position to do the things we need to do.

So my first question is: Does the panel agree with that?

And then the second question—and I will lay them both out and this way you can deal with them at the same time—is: Dr. Johnson, you said something very interesting about thinking about revenue and spending levels in the future. And I agree with what Dr. Holtz-Eakin said which is this is a mathematical formula.

We should figure out what we spend, and then we should develop revenue-gathering methodologies to match what we spend. And historically we have thought about these things in kind of the 18 to 19 to perhaps the 20 percent range, and that has been based on a looking-back approach. And whenever we have gotten outside of those bounds, either on the revenue side or on the spending side, we end up in very significant issues like we have now.

And we did both of those things. We went way outside it on the revenue and we went way outside it on the expenditures, and now we have a significant debt. It is pretty obvious.

In the future—and the world has changed. We are in a global economy. Technology has changed everything. We are likely to have a sustained period of income inequality because people with educations and access to capital do really well in this world. And then you have the demographic changes.

Should we think about that number differently? Is it 18 to 19? Or in the future is it 21 to 22? So is debt in the next 10 years the problem, is the first question. And what should that range be when we are thinking about years 11 through 20 in the future.

We'll start with Senator Gregg.

Senator Gregg. Well I do not think you can ignore the next few years. But there is no question that if you are going to address this issue in a way that has substantive impact on the future of our Nation, the prosperity of our children, and our standard of living, it is the second 10 years, and the third 10 years that are the important years, in my opinion, relative to policy changes you can make today that impact those years.

That is actually why I was so encouraged by the President putting "change CPI" on the table. Because in the first 10 years, it is not a big number relative to Washington terms. It's $200 to $300 billion. But in the second 10 years, it is probably close to $1 trillion. In the third 10 years, it is multiple trillions. It is a compounding event.

It is also why I suggested that any agreement that be reached has to be subject in the Senate to a 67-vote point of order. Because

otherwise nobody is going to believe the changes which really start to grab in the second and third 10 years.

I do believe the size of the government is going to have to grow simply because of the demographic shift. That is why, as probably one of the more fiscally conservative members of the Senate, if not the most at the time, although Coburn was on the Commission too, I voted for going to 21 percent as the size of the government under Simpson-Bowles because of the huge shift in demographics.

Representative Delaney. Dr. Rivlin.

Dr. Rivlin. The second 10 years or the third 10 years are obviously the most important, and most of the sensible reforms in entitlements do not cut in until then. And that is why we need them.

But I would not ignore the first 10 years, either. I think we can raise more revenue by reforming the Tax Code, and that would help our growth sooner than the end of 10 years.

And I do not think we know how long it might be before we had some kind of a debt crisis. And the cost of servicing the debt will rise quite quickly, even if interest rates only go back to normal.

On the size of government, we are going to have to go up, and I would think actually a little higher, to 22, 22½, is likely to be necessary to absorb this number of seniors.

Dr. Holtz-Eakin. Great questions. I feel like it's an oral exam. [Laughter.]

Let me be brief. Again, I would share the urgency about not waiting for the second 10 years. I understand we will get bigger changes from those. And there are a couple of reasons for that.

One is, you do not want to rely on the projections. The precision of these projections has enormous amounts of uncertainty. You cannot count on getting to the second 10 years in ways that the charts might appear. And that is a risk I do not want to run.

Second is, you have to somehow commit to fixing the second 10 years and do nothing in the first. It is hard to sell that, that, really, we're going to be serious in 10 years. So moving now I think is very important.

And I do not think that investing is at odds with fixing. As I said before, these are both imperatives. And lastly, I think there is a big difference between the size of government and the composition and what it does. And I think there is a very real competitiveness issue and educational reforms that we need that are not at odds with picking the size of government that is within the traditional norms.

Dr. Johnson. I agree completely with the way you framed the question. I think we need to think about human capital, investing in human capital, in a global world where we have a lot of people breathing down our necks one way or another are the only people who want to trade with us on a reasonable basis. The shift in inequality since the tax reform in 1986 is stunning, and I think was quite unexpected by anyone who was involved in designing the tax system at that point.

And I think we need to consider that and think about the opportunities for younger Americans' education and health care that is available to people who do not have a lot of resources right now but who are the foundation of productivity and competitiveness as you look out through the rest of the century.

I think we are having a very good discussion about the size of government. I think that is exactly—as Senator Gregg said, that is where you should start. What does it take to provide a reasonable level of public goods, both the productivity kind and the redistribution kind.

My math comes out with a different number, and we should look at those details. We may be talking about different end dates. But I see something more like 23, 24 percent for the medium term. I am looking out decades here. But I think that is the right conversation to have. What does it take, given your demographics, and given the public good you want to provide, and then how are you going to finance that?

I am absolutely on board with the idea that you do not say, yes, we are going to fix this in 15 years. Or, I think Senator Gregg hit the nail on the head when he said: Put in legislation that is easy to repeal when things get tough—absolutely you don't do that. Act now, but do not act for immediate austerity. You do not need that. You do not want that.

Act in a way that is consistent with investing for the future while demonstrating you have made credible commitments to fiscal responsibility. And I am here I think representing the view that you need to move much more on the revenue side than even my distinguished colleagues want to move.

Representative Delaney. Thank you.

Chairman Brady. Thank you. Representative Campbell.

Representative Campbell. Thank you, Mr. Chairman, and thank you three doctors and a senator. Could be a movie.

[Laughter.]

There is the old saying that the first step to recovery is admitting you have a problem. I first came to Congress in 2005, and I would argue then that there was a minority in both Parties that thought that the debt and deficit were a significant, or certainly "the" significant problem.

I thought we had gotten over that. I thought that by now maybe people would see that this is a serious problem, if not the most serious problem.

Yesterday, the President came and spoke to us, the House Republican Conference. Frankly, I was discouraged—not that he came and spoke; that is always good. But I was discouraged by some of what he said, which was that he made it clear that he didn't believe that balancing the budget was something that we ever needed to do.

Now I am a CPA so, you know, balancing the budget has a symmetry to it which I sort of like as an accountant. But from my view, balancing the budget is much more than that; that it is something that creates the kind of conditions, or frankly to be on the trajectory that will balance the budget will create the kind of conditions to unleash the growth that we have before us that Senator Gregg has discussed.

I believe what the President said, as I recall, yesterday was that he wanted to stabilize the deficit at 3 to 4 percent of GDP. That to me does not solve the problem. And I was discouraged by the idea that that was what his main objective was, and that any other objective beyond that he felt was unnecessary.

Your thoughts?

Dr. Rivlin. Let me start. I think the important thing now, and we have all stressed it, is not to have your debt growing faster than your GDP. And get it on a downward trajectory.

It is not necessary, in my opinion, to balance the budget exactly but we should have deficits that are well below our growth of GDP on the average. That is what we did at the end of World War II. We had a huge debt then, over 100 percent of GDP. We did not run surpluses. We ran small deficits and grew the economy faster than the debt.

We got to a more comfortable state where we were down around a debt of about 30 percent of GDP. I would like to get there eventually, but not so fast that we wreck the economy.

Dr. Johnson. What Dr. Rivlin said is exactly in line with what the International Monetary Fund says to countries around the world, and what your government through the Treasury Department urges the IMF to say to countries: Stabilize, bring down debt-to-GDP so you want to have growth. And you need to consider how much growth you can achieve when you are thinking about reasonable, responsible deficit targets.

But stabilizing, talking about, thinking about is the right debt-to-GDP for the country, that is the right conversation.

Dr. Holtz-Eakin. So I think the problem with stabilizing debt is we already have too much. So you are stabilizing at a high and dangerous level with unknown risks, like higher interest rates, which would further tie the hands of future democracies. I mean, that does not make sense for the United States.

I will speak out on behalf of balancing the budget. I mean, I am a Ph.D. economist and I was indoctrinated that balancing the budget is stupid, and primeval, and represents a neanderthal way to think, and I have come around to the point of view that we need fiscal discipline in the United States.

And a commitment to something like a balanced budget is something that will be important; that you can design balanced budget goals with sufficient flexibility for economic and national security emergencies; that they are not dangerous to growth; and that we ought to think very hard about a commitment to balanced budgets in one form or another.

Senator Gregg. If our goal is to reach a deal, we should not get engaged in this fight. I am 100 percent for balancing the budget. I did it governor, and it was my goal here in the Congress for years.

But our goal should be to stabilize the policies which are driving our debt. And that means we have got to get everybody in the room around those policies and address them. And in accomplishing that, we will make—the outcome will be, the result will be that we will move close enough to a balanced budget so that those of us who want to balance the budget will have a reasonable shot at it; and those who want to maintain a debt, a deficit of 2 to 3 percent will have their ability to make that argument, too.

But the goal—we should not get sidetracked. In my opinion, we should not get sidetracked on this debate because it really is not going to move the process forward. Our process needs to be to reach a comprehensive, bipartisan agreement—it has to be bipar-

tisan because this is a divided government—and so this debate I think sidetracks us. Even though it is very important, as a Republican, that we balance the budget, I know that that is not the position of the President and I do not want to hold him to my position in order to get a deal.

Representative Campbell. Thank you.

Chairman Brady. Thank you. I would like to welcome Senator Murphy to the Committee. And as a former House Member just out, I hope you remember some of the little people you met along the way.

[Laughter.]

We are glad you are here at the Joint Economic Committee.

Senator Murphy. That is why I asked for this Committee, to remind me of all my friends in the House.

This is a fantastic panel, Mr. Chairman. Thank you for putting it together. I have learned a lot already, and I have two questions and maybe I will only have time to fit one of them in.

But one of the things I am fascinated by is the relative unanimity of this concept that you decide what you need to spend money on, what you absolutely need, get a government no bigger than what is necessary, and then you fashion revenues around it in a way that makes sense so that you have got a revenue structure that promotes growth.

And so I think it might be worthwhile, at least for me, to spend just a little bit of time talking about from an economic perspective what we actually need to spend money on. You know, it worries me that we are spending 3 percent of our GDP on infrastructure, when Europe is spending twice that, China is spending four times that.

It worries me that it is three times as expensive today to get an advanced degree in this country in real dollars than it was in 1980; that we are spending less money today on worker training than we ever have before.

And so I guess my question is: What does the data tell us are the greatest chances to get real economic multipliers out of investment and spending? What are the accounts that you would recommend that we be protecting or advocating for increases to try to generate real economic growth?

For instance, in this last round of negotiations over the CR we seemed to protect defense spending, and very little else; when, well you certainly have an argument, aside from economic multipliers, as to why you should spend on defense, it doesn't necessarily add, as does education investment or job training investment, or infrastructure investment.

So can you guys just talk a little bit about what portions of the discretionary budget you think are most important to be held harmless in order to kind of generate economic growth down the line in this new framework?

Senator Gregg. Well that is an "eye of the beholder" issue. But the first obligation of a national government is national defense, in my opinion. That does not mean you hold it harmless, because I happen to believe the Defense Department can be subject to fairly stringent review and probably save a heck of a lot of money. And I actually think that that is one of the pluses of the Budget Act

Agreement of 2011, and the sequester, is it is going to force the Defense Department to face up to some of this.

I am a great believer in investing in infrastructure. I believe that that does give you a very significant return, and it is hard dollars on hard projects. I think the biggest failure of the stimulus package, besides the fact it was not paid for and it was too much—which were two fairly big failures—was that only 16 percent of it went into infrastructure, which was foolish.

I think R&D is important. I think education is important. But I think Dr. Rivlin has made the point: Discretionary is not where the problem is. These are all discretionary issues. The problem is not in the discretionary accounts. The problem is in the entitlement accounts when it comes to spending.

And so the focus should be entirely on entitlement accounts and how you make those deliver quality outcomes at a better price.

Dr. Rivlin. I would favor spending on smart infrastructure investment and smart education and science investment, a shifting toward those priorities. But I think it is really a question of how well you spend the money, rather than the quantity, and we have not done a terribly good job in spending on our infrastructure in the best way.

So it is not just a question of more. But the real point is the one Senator Gregg made. That unless we curb the rates of growth of spending on older people, primarily, that spending is going to squeeze out investments in young people and eventual higher growth.

Dr. Holtz-Eakin. I can only echo the comments. It is very important to spend this money well. And I spent two years on a bipartisan Transportation Policy Project looking at reforms. We have 100 transportation programs that do not unify to serve any federal purpose, and do not deliver anything in the way of economic benefits to a Nation that needs better infrastructure.

And so getting these programs to actually produce value for their dollars is step number one. That goes in other areas, as well.

I mean, I think education and health we both know are delivering products of highly uncertain quality for enormous amounts of money. They go up a lot. And we need to clean that out. And that I think is one of the hidden pieces of the defense spending.

That is not all planes, and tanks, there are big pension problems and big health problems in the defense budget, as well. We need to fix those, and that will help us focus on the core things which are national security and basic research and infrastructure, things our Founders would recognize as government.

Dr. Johnson. I would agree with much of what has been said, but want to add and reinforce the importance of children, and children's health, and children's education. I am very worried about the cuts to Medicaid.

About half of Medicaid goes to children. These are the future of the country. The way the economy has played out over the past three decades, completely unanticipated, has skewed the income distribution massively in an almost unprecedented way in this country. And it means that many people at the bottom end of the income distribution cannot invest, do not have the money to invest, in the kind of education they want for their children. And they can-

not afford decent food in some cases, or there is a tradeoff between food and health care.

This is a terrible situation.

In terms of holding people harmless, Senator, I would try to hold harmless, really try very hard to hold harmless the children who are right now in the line of fire for a lot of the austerity that is being discussed.

Senator Murphy. Thank you, Mr. Chairman.

Chairman Brady. All right. Thanks, Senator. For the final question, Representative Amash.

Representative Amash. Thanks, Mr. Chairman, and thanks to the panel for being here and sharing your insights.

I want to discuss a Constitutional balance-the-budget amendment for a little bit. About a year-and-a-half ago there were votes in the House and the Senate on balanced-budget amendments, or BBAs. There were two versions in the Senate.

The Senate had 67 Senators vote "yes" on at least one version. In the House we came up with about 23 votes short of the two-thirds necessary. States have balanced-budget amendments in their constitution, and they follow different fiscal rules.

So I want to ask Dr. Johnson. You have had concerns about capping spending as a percentage of GDP. Could you elaborate on those concerns?

Dr. Johnson. Well actually I was expressing support for what Senator Gregg said, which is you should first decide what is the right level of spending as you look out over some decades, given the nature of your society, how you think the world is going to change, what threats you will face militarily and non-military threats, and what role you want government to play.

And obviously there is a very wide range of views about the role of government in this room, but that is the right place to start the discussion. If you can agree on that, and we have heard 19 percent, 21 percent, 22 percent, and I think I am at 23, 24 percent, that is about the right spectrum for views, once you have decided on that, then figure out how to fund that in a responsible way.

And aiming for balancing the budget I think is fine. I also agree with Senator Gregg, it gets in the way now. And the right way to operationalize the goal is to think about debt relative to GDP.

Representative Amash. But you would object to putting into a balanced budget amendment a cap?

Dr. Johnson. I have never—I have never and will never describe the idea of balancing the budget as neanderthal or primitive. That is not my view. The United States was run for the first 150 years on the principle that we should aim to balance the budget at least in good times.

However, there come times which are not so good, and there are times like this in the 19th Century, also, where it is advisable to have the ability to slip out of balance towards a deficit, assuming that you share the goal of coming back towards, more closely towards a balanced budget, and bringing down the debt-to-GDP.

My goal for debt/GDP is far below where it is today, and far below where it is in those charts. I want 40 to 50 percent, based on experience. But that is the heuristic I would propose for the modern world, not the heuristic that served them well in the 1830s.

Representative Amash. Dr. Rivlin, would you oppose the idea of putting a cap, a percentage of—spending as a percentage of GDP in a balanced-budget amendment?

Dr. Rivlin. I think it is a diversion from the real problem, which is thinking about how do we control the cost of the entitlements so they are not rising faster than the economy is growing.

That is hard. And we have got to do it. And how do we set up a tax system that is more pro-growth? Putting algebra in the Constitution, as my former colleague, Charlie Schultz, used to say, does not solve anything. If you are to put a balanced-budget amendment in, you have to put in so many exceptions that it is gobbledegook. I would not do it through the Constitution. I would do it through action of the Congress and the President.

Representative Amash. How about the idea of just balancing the budget every year, with the exception of emergencies? Would you support that idea?

Dr. Rivlin. No, I would not support it as a general idea because there are emergencies. We have just lived through an emergency.

Representative Amash. But with the exception of an emergency. I think any balanced-budget proposal is going to have an escape clause for emergencies.

Dr. Rivlin. Well it would depend on what an "emergency" is. If the economy is in deep recession, balancing the budget is a crazy and counter-productive thing to do.

Representative Amash. Would you be more likely to support a policy, say a Constitutional amendment, that was countercyclical?

Dr. Rivlin. Then you get into the writing algebra into the Constitution. I am opposed to doing this through the Constitution. Do it through policy.

Representative Amash. Senator Gregg, in June 2011 you wrote that conservatives must not let advocacy for a balanced-budget amendment be an excuse for avoiding votes on difficult but crucial reforms. And you have echoed that here. And I agree with that.

Do you have any intrinsic objections, though, to a well-crafted bipartisan and broad balanced-budget amendment?

Senator Gregg. No. I supported it numerous times. My point there was that there were—a balanced-budget amendment is going to take years to ratify. Years. And it gives some people political cover to say, well, I am for the balanced-budget amendment therefore I do not have to make this tough vote because I have already voted for the balanced-budget amendment.

There are very tough votes that are going to have to be made here that have nothing to do with whether or not you are for or against a balanced-budget amendment, and you should not—and people should not use the balanced-budget debate as a way to get off the point of making those tough votes. That was my point.

Representative Amash. Mr. Chairman, may I ask one more question?

Chairman Brady. We are out of time, Representative. I apologize about that. If you would like to submit it in writing to the witnesses, would you mind responding promptly to the Representative?

[Panel Members nod affirmatively.]

Representative Amash. Thank you, Mr. Chairman.

Chairman Brady. Thank you, so much. This is such a great discussion, I frankly hate to end that way since this has been one of the most thoughtful and insightful panels we have had an opportunity to hear from. This is the right issue at the right time.

One theme we hear is the easy votes are over. If we are going to tackle our biggest challenges, the easy votes are decades behind us. And so on behalf of Vice Chair Klobuchar and myself, I want to thank you all for being here. Thanks to the Members for their questions.

The hearing is adjourned.

[Whereupon, at 11:09 a.m., Thursday, March 14, 2013, the hearing was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF SENATOR DAN COATS

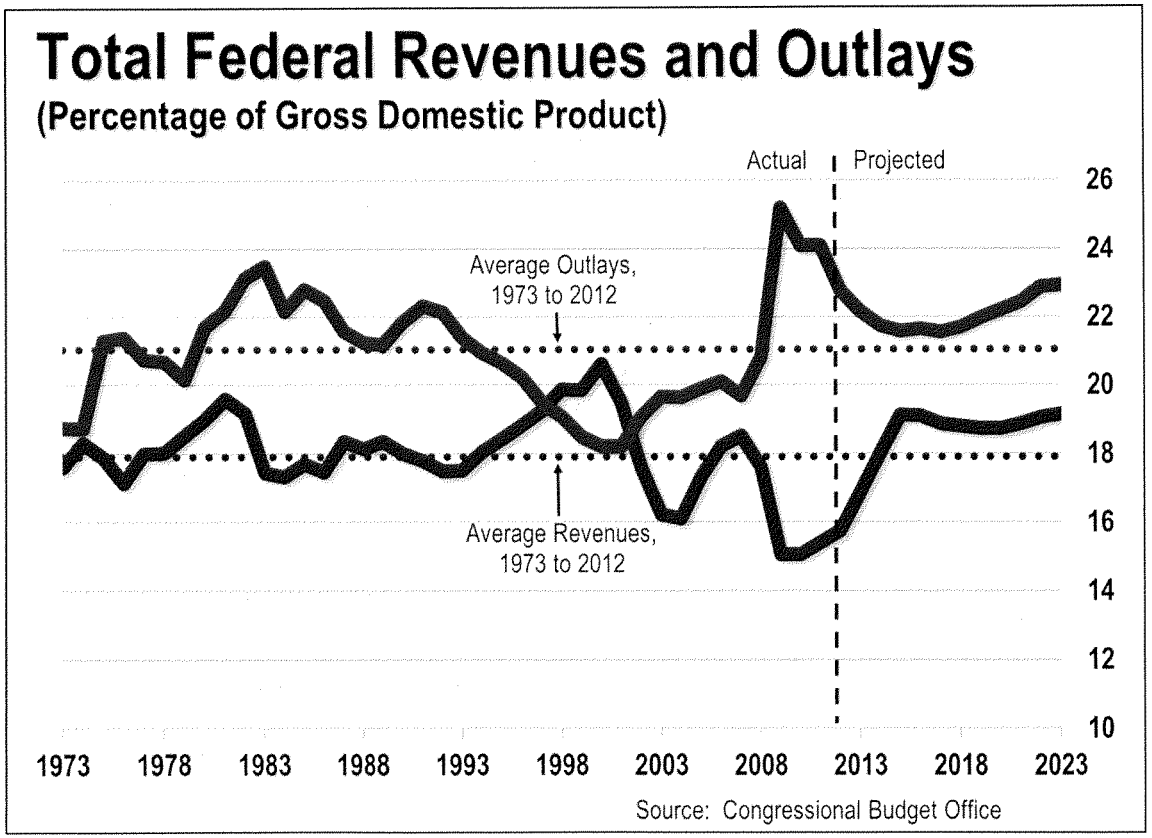
- I would like to thank Chairman Brady and Vice Chair Klobuchar for holding this hearing on a subject of the most vital importance for our nation's economy and, indeed, our national security: the ever-growing federal debt.
- Our spending addiction in Washington has, at long last, led us to the point where we now face the prospect of record deficits as far as the eye can see, a spiraling federal debt that now exceeds $16 trillion, and the possible further downgrading of the credit rating of the United States. Were interest rates not artificially held down by the Fed at historically low levels, we might already be facing our day of reckoning. According to the Congressional Budget Office, even a one percentage point increase in interest rates would add $1.1 trillion to the United States' debt over ten years. And that new debt would occur without any changes in spending or taxes, so individuals would have no more money in their pockets and the government would not be spending any more—interest rates would simply drive our debt out of control.
- The fact is that Congress and the Executive branch have utterly failed to address the debt crisis effectively. Temporary stopgap measures, such as the recent suspension of the debt limit for four months, don't solve anything—they simply put off the inevitable day of reckoning. Despite the hype, the supposedly "massive" sequester cuts will do little to improve the long-term fiscal condition of our nation. According to the Bipartisan Policy Center, these arbitrary, poorly designed budget cuts will merely delay our national debt reaching 100 percent of GDP by two years.
- Eventually, we will reach a point where investors either stop buying our debt or insist on higher interest rates to account for their greater risk, potentially triggering a crisis of confidence. We do not know when that tipping point will be, but if you look at our total government debt as a percentage of GDP compared with some nations that have already reached that tipping point and gone into full-fledged fiscal crisis, it is cause for serious concern. We all know that we are going to have to make the tough spending choices that we've been avoiding for years, or we are going to face a debt-induced catastrophe that will make the economic downturn we experienced a few years ago look minor by comparison.
- Many experts believe that our failure to seriously grapple with our ballooning national debt is already having a significant detrimental impact on economic growth. They understand that a mounting debt will one day need to be paid for with either higher taxes or reduced benefits. Our failure to deal with our spending addiction and long-term debt has created a cloud of economic uncertainty that suppresses consumer confidence. It's causing investors to remain on the sidelines and preventing business owners from hiring new employees. Our refusal to address out-of-control deficit spending is like a foot on the neck of the economy.
- We all know—or we ought to know—that our current path is unsustainable. Academics, economists, business leaders, and even the bi-partisan Simpson-Bowles Commission established by the President all repeat the same thing: unless we make the tough spending choices that we've been avoiding for years, we are going to face a debt-induced catastrophe. It is only a matter of time, and the clock is running down.
- There is widespread agreement that the only way to get our long-term debt under control is to tackle the difficult problem of soaring mandatory spending. According to the Simpson-Bowles Commission Report:

> By 2025, revenue will be able to finance only interest payments, Medicare, Medicaid, and Social Security. Every other federal government activity—from national defense and homeland security to transportation and energy—will have to be paid for with borrowed money. Debt held by the public will outstrip the entire American economy, growing to as much as 185 percent of GDP by 2035. Interest on the debt could rise to nearly $1 trillion by 2020. These mandatory payments—which buy absolutely no goods or services—will squeeze out funding for all other priorities.

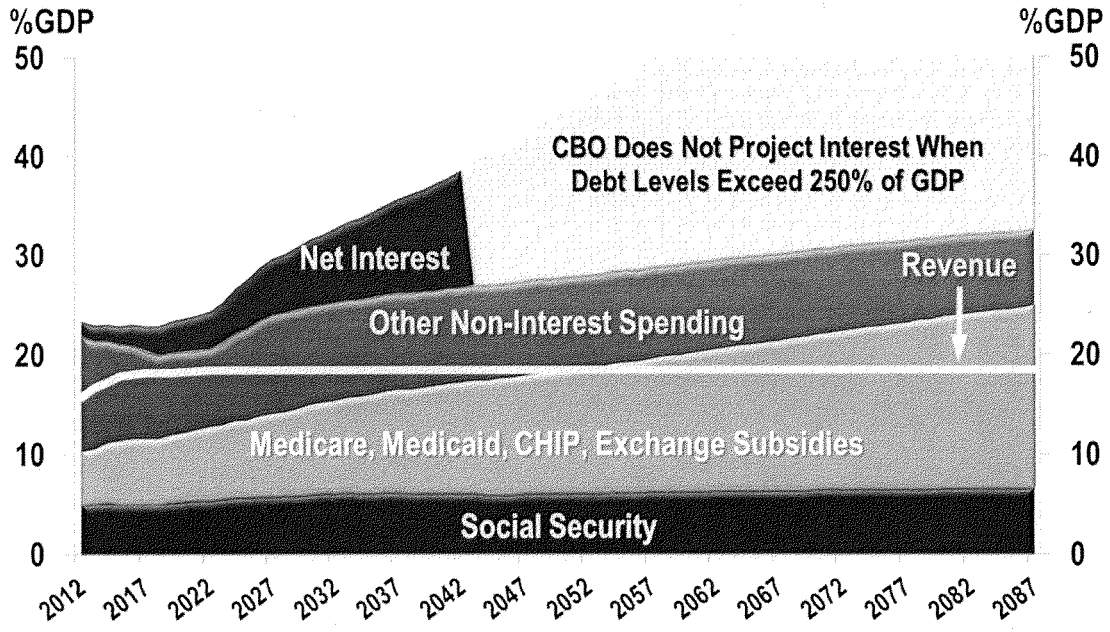
- The plain fact is, in order to make a real impact on the deficit and the federal debt, we need to go big and go bold. In addition to discretionary spending reforms, we need real action on reforming our mandatory spending. Medicare, Medicaid, Social Security, and ObamaCare are projected to outstrip all tax revenue. There simply won't be enough money to spend on anything else.
- We won't have enough to cover our commitments to seniors either. In America, we have always prided ourselves on fulfilling our commitments to future gen-

erations, but our failure to act now all but ensures drastic cuts to Medicare and Social Security beneficiaries in the future.

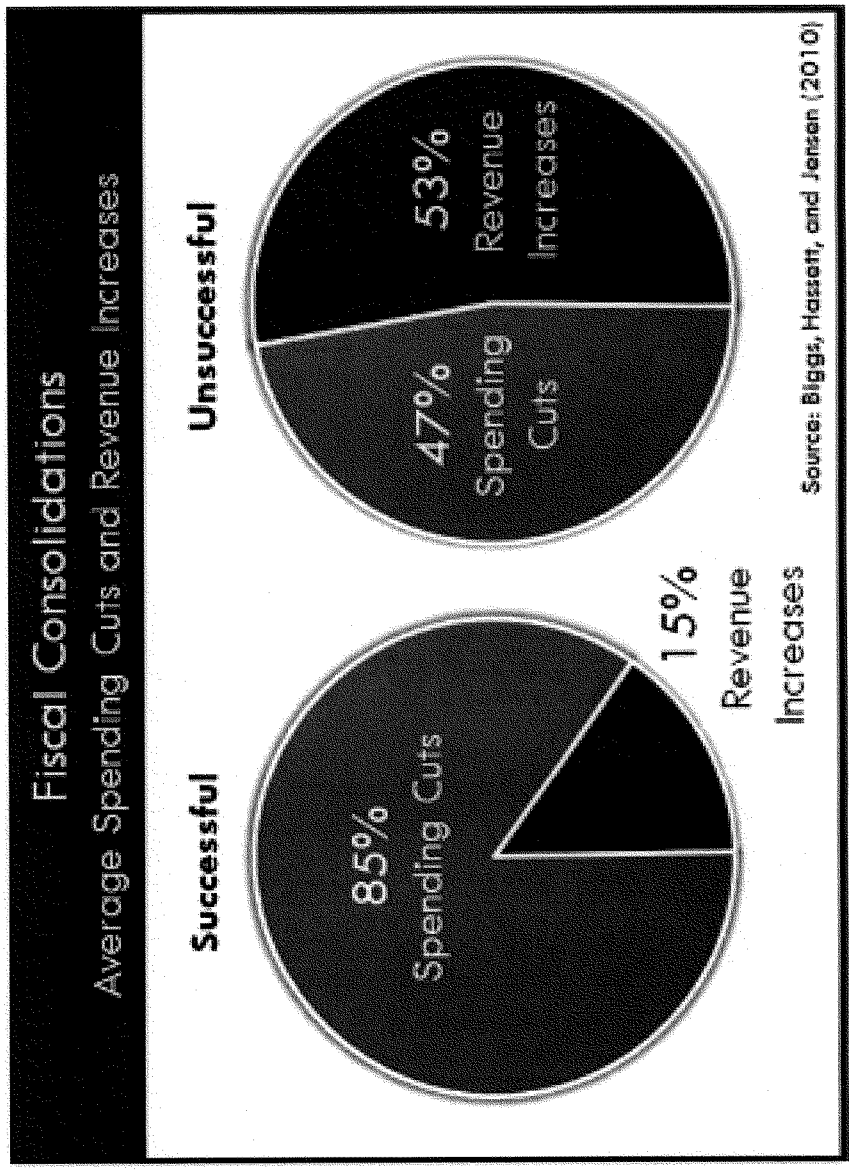
- Today's hearing presents us with an opportunity to find common ground in tackling these difficult issues. We will hear about a number of different approaches to tackling our long-term debt problem and explore where there is agreement and where there is disagreement. I look forward to the testimony of the expert witnesses we have assembled here today to address the question of how we go about solving our federal debt crisis.


Total Federal Revenues and Outlays
(Percentage of Gross Domestic Product)
Actual
Projected
Average Outlays, 1973 to 2012
Average Revenues, 1973 to 2012
26
24
22
20
18
16
14
12
10
1973
1978
1983
1988
1993
1998
2003
2008
2013
2018
2023
Source: Congressional Budget Office

Long-Term Spending vs. Revenue Outlook



Source: CBO Long-Term Budget Outlook (June 2012), Joint Economic Committee Staff


Fiscal Consolidations
Average Spending Cuts and Revenue Increases
Successful
85%
Spending Cuts
15%
Revenue
Increases
Unsuccessful
47%
Spending
Cuts
53%
Revenue
Increases
Source: Biggs, Hassett, and Jensen (2010)

PREPARED STATEMENT OF SENATOR JUDD GREGG

Chairman Brady, Vice Chair Klobuchar, Senator Coats, Representative Maloney and other members of the Committee, I appreciate this opportunity to discuss the state of the national debt.

Robert Zoellick, the past head of the World Bank, is fond of telling the story of how the Foreign Minister of Australia said to him a few months ago that: "America is one debt deal away from leading the world out of its economic doldrums."

He is right.

Dangerously, some observers believe the country has completed its work on deficit reduction. Despite some improvements, however, the debt will continue to rise as a share of our economy over the long-term. This fact continues to present a serious economic danger for the United States.

We are now engaged in the struggle to obtain a debt deal large enough to stabilize the debt and put it on a downward path, at a time when Washington and the media are energized on the issue of dealing with the sequester.

We know the problem. It is that our present rate of accumulating debt due to our historically large deficits will inevitably lead to a fiscal crisis.

THE DRIVERS OF OUR NATION'S LONG-TERM DEBT LOAD

Any debt reduction plan needs to primarily focus on changes to those programs that are driving the problem. These of course are the major entitlement accounts, Medicare, Medicaid and Social Security, along with comprehensive tax reform.

While it is has been good to see progress made over the last two years on enacting some savings, unfortunately all of the measures put in place have ignored smart entitlement reforms to control spending over the long-term and comprehensive tax reforms to make the tax code more efficient. These are the primary fiscal challenges facing us, and we can no longer avoid them. We've done the easy work of deficit reduction—enacting discretionary limits and raising taxes on wealthy Americans. We must renew our focus on the remaining elements of fiscal reform.

Rising health care costs and an aging population are the central drivers to our rising debt trajectory. We cannot continue to let health care costs rise faster than our National income. We must find ways to adopt sensible reforms to address population aging and rising health care costs this decade before costs reach untenable levels.

Smart entitlement reforms need to involve adjustments which grab hold in five years, ten years, and fifteen years so that they make these programs sustainable and affordable not only in the next few years, but in the long term.

HOW DEFICITS AND DEBT INHIBIT ECONOMIC GROWTH

Professors Reinhart and Rogoff have done exceptional work on documenting the inevitability of a reduction in economic well-being if our debt to GDP ratio passes certain benchmarks, which we are quickly closing in on. A large number of other studies from universities, the Congressional Budget Office, the International Monetary Fund, and other organizations worldwide show us that the conclusion is clear: rising debt will hold back strong economic growth down the road. This occurs as rising debt pushes up interest rates, "crowding out" private investment.

Equally important is the fact that it is a distinct likelihood that the financial markets themselves will at some point, sooner rather than later, look at our massive accumulation of debt and conclude that we will be unable to pay it back. The markets will react to this by assuming that the currency will have to be devalued through inflation and the cost of servicing our nation's debt will jump radically. This will significantly compound what will be a dire fiscal situation.

Debt reduction done right can actually strengthen the economy down the road. A recent analysis from the Congressional Budget Office found that a $2 trillion reduction in primary deficits could boost the size of GNP by nearly 1% over ten years. And in the short-term, there is evidence that just the announcement of a long-term deficit reduction plan could bolster the recovery by improving confidence and certainty about United States fiscal policy.

WHAT AMOUNT OF DEFICIT REDUCTION IS NEEDED

The "deal" that can avoid this crisis is apparent and very doable.

The goal of deficit reduction must be to put the debt on a clear downward path as a share of the economy, this decade and over the long-term. Achieving that goal will require reducing the debt to below 70% of the size of the economy by 2023.

The good news is that the President and Congress has tried over the last several years to grapple with how to come to terms with our debt problems and have accom-

plished a hard $2.5+ trillion dollars of debt reduction out of the total needed. The Budget Control Act of 2011 cut $917 billion dollars in mostly discretionary spending, prior continuing resolutions enacted hundreds of billions in discretionary spending savings over ten years, and the fiscal cliff agreement, formally known as the American Taxpayer Relief Act, generated over $600 billion dollars in new revenues. These were serious steps down the road of putting our fiscal house in order, but we are not there yet.

In the wake of these efforts, getting control over our debt will require additional deficit reduction.

Our fiscal problems will self-correct if our government reduces our deficits and debt over the next ten years by at least an additional $2.4 trillion dollars in reforms, reforms that should also increase in their effectiveness beyond this ten-year window. In total, this would produce over $5 trillion in savings when including the policies we have already put in place. This represents the minimum amount of savings needed to put the debt on a downward path as a share of the economy to below 70%.

Ideally, lawmakers would aim for an even larger amount of savings. In today's terms, the President's own National Commission on Fiscal Responsibility and Reform would produce a total of between $6.5 and $7 trillion in savings over ten years—an even more aggressive target.

Some observers have said we only need an additional $1.5 trillion in savings over the next ten years in order to stabilize the debt as a share of the economy. While it is true that $1.5 trillion would likely stabilize our debt this decade, it would likely be insufficient to control the debt over the long-term, leaving the country open to serious risks, including:

- No Room for Error for future deficit-increasing policies or if economic projections are too rosy;
- No Long-Term Stability in the face of rising health care and retirement costs that become harder to contain later this decade and beyond, requiring a "running start" to control the debt and interest payments later on;
- Slower Economic Growth due to higher interest rates "crowding out" investment; and
- No Fiscal Flexibility in the case of natural disasters, security needs, or an economic downturn.

Putting debt on a downward path with another $2.4 trillion in new deficit reduction would address the risks. This may seem like a great deal of money, but when one considers that it is off a base of approximately $40 trillion dollars of spending over the next ten years, it is definitely manageable.

WHAT POLICIES CAN CONGRESS PURSUE TO REDUCE THE DEBT AND ENCOURAGE ECONOMIC GROWTH

Most of the changes that are needed now, unlike the practical effect of continuing to reduce spending through the sequester, are changes to entitlement programs and tax policy which can and should compound in their effectiveness as we move beyond this initial ten year window.

What is the deal we need? It should obviously start by an agreement to replace the sequester with targeted and effective changes to federal fiscal policy that gets a reduction in the deficit over the next ten years of at least $2.4 trillion dollars and that can be presumed to do significantly more than that in the following decades. It should be an agreement that at a minimum has a goal of stabilizing our debt to GDP ratio at 70 percent or less. Why wait for another fiscal speed bump to address these issues?

The President proposed a specific change, which would be a significant contributor to this type of responsible action, when he proposed changing the manner in which the Federal cost of living adjustment (COLA) is calculated to make it more accurate.

In their latest framework, Sen. Simpson and Erskine Bowles have put forward $600 billion as a credible and bipartisan target for health savings over ten years, which could be achieved through various options, including many outlined by the Committee for a Responsible Federal Budget, which I have attached to my testimony. It is a specific and doable list. Much of it is directed at making Medicare and Medicaid better programs by focusing on outcomes and value rather than utilization and repetition.

Of course, there is also the proposal for approximately $200 to $300 billion in entitlement savings that was reportedly agreed to between the President and the Speaker in the summer of 2011 and which was further discussed during the fiscal

cliff negotiations. These are presumably well-vetted ideas that are essentially off the shelf ready for a "deal."

Take any permutation of these proposals and add in the CPI change proposed by the President, known as "chained CPI" and throw in a long-term adjustment in the eligibility age for Medicare and Social Security (which reflects the large increase in life expectancy that we have seen and will continue to see) and you have the spending side of a very strong package.

Comprehensive tax reform is also necessary. Although a significant majority of the reduction in our deficit must come from the spending side of the ledger, reforming the tax code to lower rates and broadening the tax base will be good both for the economy and our fiscal health. Ironically, Senator Coats, the lead Senate Republican of this Committee has, along with Senator Wyden, proposed such an approach and it would be a good guide to developing a bipartisan, strong bill to fundamentally improve and reform our tax policy as a nation making us more competitive.

There are at least two other crucial points that the "deal" must include. First, it must be based off an agreement that fixes the size of the government as a percent of GDP. The federal government since the end of World War II through 2007 has been approximately 19.8 percent of GDP. In the last few years it has grown to over 23.5 percent and is still headed up. Some of this growth is inevitable due to the retirement of the baby boom generation, which is doubling the number of retirees in our society. Agreeing to fix the size of the government to a percent of the GDP that is closer to its historical range is essential to driving long-term solutions to our debt problem. The National Committee on Fiscal Responsibility and Reform used the metric of 21.3 percent, which is realistic in light of the demographic shift. This metric also sets an appropriate relationship between spending restraint and revenues of about three to one in the out years.

Secondly, all entitlement changes that reduce projected spending need to be locked in with a procedural provision that keeps later Congresses from arbitrarily rescinding them. This can be done by making attempts to reverse such changes subject to a 67 vote point of order in the Senate.

The opportunity for the "deal" is sitting there. It is not rocket science or, for that matter, even model rocket science. It is very doable and all the policy options are well debated, vetted, and known. It should be simply done so that a predictable fiscal crisis can be muted and our nation can move on as a better and stronger place for ourselves and our children.

Attachment of Sen. Judd Gregg
Health Savings Options
Source: The Committee for a Responsible Federal Budget
http://crfb.org/document/report-health-care-and-revenue-savings-options

Health Care Savings Options	Potential 2013-2022 Savings
Expand Current Income-Related Premiums	**$10 - $70 billion**
Freeze Income-Related Thresholds for Part B and Part D	$10 billion
Increase Income-Related Premiums by 15%	$25 billion
Reduce Threshold for 35% Premium from $85,000 to $50,000	$25 billion
Impose Part A Premium on Higher Earners Making Above $250,000	$10 billion
Increase Premium Base Rates	**$75 - $330 billion**
Increase Medicare Part B Base Rate to 35 Percent of Program Costs	$250 billion
Increase Medicare Part D Base Rate to 35 Percent of Program Costs	$80 billion
Increase Premiums by 5 Points Across-the-Board (incl. means-tested)	$190 billion
Increase New Beneficiary Premiums by 5 Points Across-the-Board	$75 billion
Modify Existing Cost-Sharing for Current and/or Future Beneficiaries	**$10 - $100 billion**
Increase Part B Deductible by $75 (for 2012 it is $140) by 2020	$10 billion
Impose a 10% Home Health Copayment	$40 billion
Impose Cost-Sharing for Skilled Nursing Facilities	$20 billion
Impose Copayments for Clinical Laboratories	$25 billion
Overhaul Medicare Cost-Sharing System	**$30 - $65 billion**
Establish Unified Deductible of $550, 20% Uniform Coinsurance, and $5,500 Out of Pocket Limit	$30 billion
Impose a 5% Coinsurance Above the Initial Out-of-Pocket Limit	$25 billion
Give IPAB authority to Adjust Coinsurance rates	n/a
Combine Cost-Sharing Overhaul with Medigap Restrictions	$10 billion
Restrict Medigap Coverage	**$10 - $100 billion**
Ban Medigap Plans from Covering First-Dollar Costs (first $550) and Limit Coverage to 50% of Remaining Cost-Sharing	$55 billion
Apply Above Medigap Restrictions to TRICARE for Life	$35 billion
Apply Above Medigap Restrictions to Employer Plans	Unknown
Replace FEHBP Wraparound Coverage for Medicare with Premium Subsidy	$10 billion
Impose 15% Premium Surcharge for Certain Medigap Plans	$15 billion
Levy 5% Surtax on all Medigap Plans	$15 billion
Increase Medicare Age	**Up to $150 billion**
Increase Medicare Age by 2 Months Per Year Until It Reaches 67	$150 billion
Increase Medicare Age by 1 Month Per Year Until It Reaches 67	$75 billion
Establish Medicare Buy-in at Age 65 or Age 62	-$1 billion
Once Medicare Age Reaches 67, Index to Longevity	Future Savings
Make Changes to Medicare Advantage	**Up to $30 billion**
Recover Erroneous Payments Made to Medicare Advantage	$2 billion
Repeal Quality Bonus Demonstration	$6 billion
Accelerate Phase-in of All Benchmarks and Coding Intensity Adjustments	$10 billion
Prohibit Medicare Advantage Plans from Exceeding 110% of FFS Costs	$10 billion
Adjust Timing of Medicare Advantage Payments	$2 billion
Reform Graduate Medical Education Payments	**$5 - $70 billion**
Consolidate GME and IME Payments Into a Grant and Grow at CPI-1%	$70 billion
Limit GME Payments to National Average Salary and Reduce IME	$55 billion

Health Care Savings Options	Potential 2013-2022 Savings
Payments Adjustments from 5.5 to 2.2 Percent	
Enact More Modest Adjustments to GME and IME	$5 to $20 billion
Require Private Insurers Pay $2 per Enrollee by 2014 to Contribute to GME	$4 billion
Reduce Payments for Bad Debts	**$23 - $35 billion**
Reduce Bad Debts Reimbursements from 65% to 25% of Costs	$23 billion
Phase Out Bad Debts Payments	$35 billion
Reform Rural Hospital Payments	**Up to $30 billion**
Cut All Special Payments to Rural Hospitals in Half	$30 billion
Reduce Payments to Critical Access Hospitals (CAH) from 101% to 100% of Reasonable Costs	$1 billion
Prohibit CAH Designation for Facilities within 10 Miles of a Hospital	$1 billion
Reform Post-Acute Care Payments	**Up to $55 billion**
Reduce Skilled Nursing Facility (SNF) Payment Updates by About 1.1%	$12 billion
Reduce Skilled Nursing Home Health Payment Updates by About 1.1%	$25 billion
Equalize Certain Payments to SNFs and Inpatient Rehabilitation Facilities	$1 billion
Reduce Readmissions to Skilled Nursing Facilities	$2 billion
Institute Value Based Purchasing for Home Health and SNFs	$4 billion
Reduce IRF and Long Term Care Hospital Payment Updates by 1.1%	$8 billion
Return to the 75% Rule for IRFs	$1 billion
Institute Premium Support/Defined Support/Competitive Bidding	**Dialable**
Switch Medicare to a Premium Support/Defined Support/Competitive Bidding Plan Without a Cap *(Savings Depend on Subsidy Benchmark)*	Unknown
Switch Medicare to a Premium Support/Defined Support/Competitive Bidding Plan w/ a Cap on Subsidy Growth Rate	Dialable
Switch Federal Employees Health Benefits Program to a Premium Support System with a Cap	$10 - $40 billion
Reform or Replace Sustainable Growth Rate ***(Estimates Relative to a 10-year Freeze of Physician Payments)***	**Dialable**
Index Physician Payments to Medicare Economic Index	-$90 billion
Reset SGR Target at 2011 Spending Levels	$15 billion
Reduce Payments by 1% in 2014, Require CMS to Develop New Payment Formula Enforced w/ Rebased SGR in 2015 (Fiscal Commission Recommendation)	$35 billion
Freeze Payment Rates for Primary Care Physicians and Reduce Other Rates by 16.5 Percent (MedPAC Recommendation)	$80 billion
Enact Medical Malpractice Reform	**Up to $70 billion**
Implement 3-Year Statute of Limitations, a Fair-Share Rule, Collateral Source Rules, and Limits on Lawyer Contingency Fees	$15 billion
Impose Caps on Noneconomic Damages (at $250,000) and Punitive Damages (at the greater of $250k or twice the economic damages)	$50 billion
Institute Evidence-Based Practice Guidelines and Safe Harbor Protections	$5 billion
Reform the Medicaid Payment Formula	**Dialable**
Establish Per Capita Cap on Medicaid Growth	Dialable
Block Grant Medicaid and Set a Fixed Growth Rate	Dialable
Allow up to 10 States to Submit Medicaid Waivers to CMS, under an Expedited Waiver Approval Process	Unknown
Reduce Federal Medical Assistance Perentage (FMAP) Rates Across-the-Board	Dialable
Move to a "Blended Rate" for Medicaid and CHIP	Dialable
Reduce Floor on FMAP Matching Rates	Dialable (~$300b max)

Health Care Savings Options	Potential 2013-2022 Savings
Enact Targeted Medicaid Changes	**Up to $100 billion**
Reduce Medicaid Provider Tax Threshold	$10 - $65 billion
Reduce Duplicative Administrative Payments to States	$3 billion
Equalize Federal Matching Rates for Administrative Function At 50%	$25 billion
Allow States to Increase Medicaid Cost-Sharing	Unknown
Reduce Medicaid DME Payments to Medicare Levels	$3 billion
Rebase Medicaid Disproportionate Share Hospital (DSH) Payments for FY2022 and on Permanent Basis	$4 billion
Require Drug Rebates in Medicare	**$50 to $135**
Require Rebates for Brand Name Drugs for Dual Eligibles	$75 billion
Require Rebates for Brand Name Drugs for Other Low Income Subsidy (LIS) Beneficiaries	$45 billion
Require Rebates for Generic Drugs For Dual and LIS Beneficiaries	$25 billion
Reduce Federal Spending on Prescription Drugs	**Up to $85B**
Prohibit "Pay for Delay" Agreements	$5 billion
Encourage Faster Introduction of "Biosimilar" Drugs from 12 to 7 Years	$3 billion
Reduce Part B Drug Payments from Average Sales Price (ASP)+6% to ASP+3%	$3 billion
Establish Rebate for Part B Drugs Administered in Physicians' Office	$15 billion
Adjust Medicaid Inflation Rebate	$20 billion
Allow Drug Re-importation	$20 billion
Change Cost-Sharing in Medicare Part D LIS to Encourage Use of Generics	$20 billion
Reduce/Reform Select PPACA Provisions	**Dialable**
Repeal Frontier State Adjustments	$2 billion
Exclude Part D 50% Discount from Out-of-Pocket (OOP) Cost Calculation	$85 billion
Eliminate Cap on Subsidy Recapture	$45 billion
Repeal Prevention and Public Health Fund	$10 billion
Repeal Individual Mandate	$335 billion
Institute a Public Option	$100 billion
Require Health Insurance Exchanges to Offer Tiered Insurance Plans	$10 billion
Reduce PPACA Subsidies	Dialable
Enact Payment Reforms	**Up to $95 billion**
Aggressively Expand Penalties for Avoidable Complications	Up to $23 billion
Aggressively Expand Penalties for Avoidable Hospital Readmissions	Up to $29 billion
Expand Competitive Bidding to All Durable Medical Equipment	$10 billion
Expand Competitive Bidding to Medical Devices and Lab Services	$25 billion
Expand Payment Bundling and Other Pilot Programs	$10 billion
Other Provider Payment Reductions	**Up to $45 billion**
Recoup Hospital Coding Intensity Adjustments	$3 billion
Pay Hospital Outpatient Evaluation and Management (E&M) Visits at Physician Fee Schedule Rate	$10 to $20 billion
Modify Payments and Require Prior Authorization for Advanced Imaging	$2 billion
Reduce Payments to Clinical Labs by 5%	$5 billion
Reduce Cap on Rental for Oxygen Concentrators from 36 to 13 Months	$10 billion
Reduce Medicare Payments to End-Stage Renal Disease Facilities	$4 billion

"Growing the Economy and Stabilizing the Debt"
Testimony of Alice M. Rivlin*
to the
Joint Economic Committee
U.S. Congress
Thursday, March 14, 2013

Chairman Brady, Vice Chairman Klobuchar, and members of the Committee:

This hearing is called: "Flirting with Disaster: Solving the Debt Crisis." I would like to suggest an alternative title: "Avoiding Disaster: Growing the Economy and Stabilizing the Debt." I make this suggestion because I believe strongly that future American prosperity requires bipartisan cooperation to achieve two goals at once:

- Faster economic growth that will create more jobs and bring the unemployment rate steadily down at least to the 5-6 percent range.
- A sustainable long-run budget plan that will halt the projected rise in the debt/GDP ratio and put it on a downward trajectory by the end of the decade.

The two goals reinforce each other and neither can be achieved without the other. Weak economic growth—or worse, sliding back into recession—will reduce revenues and make it much harder to reduce or even stabilize the ratio of debt to GDP. But the prospect of debt growing faster than the economy for the foreseeable future reduces consumer and investor confidence, raises a serious threat of high future interest rates and unmanageable federal debt service, and reduces likely American prosperity and world influence.

Stabilizing and reducing future debt does not require immediate austerity—on the contrary, excessive budgetary austerity in a still-slow recovery undermines both goals—but it does require a firm plan enacted soon to halt the rising debt/GDP ratio and reduce it over coming decades. Financial markets will not provide advance warning of when such a plan is required to avert negative market reactions. At present the United States appears to have unlimited access to world markets at low interest rates But this market confidence could evaporate quickly, possibly because of developments elsewhere around the world and beyond our control. The sooner we enact such a plan, the better the prospects for our economy. There is no valid argument for delay.

Putting the budget on a sustainable path and reducing the debt/GDP ratio will require bipartisan agreement on entitlement reform that slows the growth of health care spending and puts Social Security on a firm foundation for future retirees. It will also require

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*Alice M. Rivlin is a Senior Fellow at the Brookings Institution and a Visiting Professor at Georgetown University. The views expressed in this statement are strictly her own and do not necessarily reflect those of staff members, officers, or trustees of the Brookings Institution or Georgetown University.

raising additional revenue through comprehensive tax reform. I have spent much of the last several years participating in two high-profile bipartisan groups that crafted plans to grow the economy and stabilize the debt—the Simpson-Bowles Commission and the Domenici-Rivlin Task Force. That experience convinced me that bipartisan problem-solving is possible when participants are willing to confront facts objectively, listen to each other, and seek common ground. An updated version of Domenici-Rivlin is attached.

Although detailed recommendations of the two groups differed, each involved three elements: (1) restraining discretionary spending; (2) reducing the growth of Medicare, Medicaid and stabilizing Social Security: and (3) comprehensive tax reform to cut spending in the tax code and raise additional revenue. Indeed, the arithmetic of the problem makes all three elements necessary. More than enough discretionary spending restraint has already been accomplished. The task remaining is to find agreement on an acceptable set of entitlement and tax reforms.

Why Sequestration is Bad Policy and Should be Replaced

Sequestration is a mindless across-the-board cut designed to be such bad policy that it would never happen, and they should not be continued. Cutting discretionary spending will add to the restraining effect that the declining federal deficit is already having on the still-slow recovery, will reduce job creation, and will possibly even trigger a new recession. Domestic discretionary spending has already been reduced by more than the two bipartisan groups recommended and is scheduled to fall to historic lows. Such low levels of domestic discretionary spending endanger the government's ability to perform essential functions that the public wants and needs. Indeed, higher investment in science, education, and modern infrastructure is needed to foster future productivity and job creation. While savings in defense can be made over time, they should result from serious planning, not meat-ax proportional cuts regardless of priorities. Since discretionary spending is not a driver of future deficits, cutting it contributes next to nothing to slowing the projected increases in spending that will push the debt/GDP ratio upward over the next several decades. Sequestration weakens both the economy and the government's ability to do its job. It should be replaced by gradually phased in tax and entitlement reforms that will stabilize the debt. I am concerned that Chairman Ryan's budget blueprint released on Tuesday continues to target nondefense discretionary spending, cutting it substantially more than the current sequester.

Why Entitlement Reforms are Necessary Now

Over the coming decades federal spending is projected to increase faster than the economy can grow, because a tsunami of older citizens are reaching retirement age and living longer than their predecessors, and spending for health care, disproportionately consumed by seniors, is likely to rise faster than other spending. This combination of demographics and health spending growth makes Medicare, Medicaid and Social Security drivers of unsustainable federal spending in future years.

Social Security should be the easiest to reform, because it involves only money—without the complexity of health care delivery—and requires fairly minor, well understood

tweaks in benefits and revenue to regain fully funded status. Social Security is an extremely successful program, which keeps millions of seniors from destitution in old age. Workers now in the labor force need to know that Social Security will be there for them when they retire or if they become disabled and that they can plan their retirement around it. The Domenici-Rivlin Task Force recommended indexing benefits to longevity (rather than further increasing the age of full retirement beyond 67); adding a bend point in computing initial benefits to reduce payments to high income people, switching to a chained CPI for indexing benefits, while protecting the lowest income and most aged recipients; and raising the cap on wages faster than under current law. Taken together, the Domenici-Rivlin Social Security recommendations ***increased*** benefits for low-income seniors while reducing those for affluent beneficiaries in order to achieve solvency.

Enactment of such a bipartisan package now would reassure current workers, demonstrate that our democracy works to solve problems before they reach crisis proportions, and contribute to stabilizing the debt. Fixing Social Security would send a strong signal to the financial markets that the nation was addressing its long-term budget problem, and, because its effects would be felt in future years, it would not threaten the current economic recovery.

Some have suggesting waiting until the Social Security Trust Fund runs out of money around 2033 before instituting reforms. This would be shortsighted and irresponsible. Workers who will be retiring in 2033 are already in their mid-forties. We owe it to them to fix Social Security now, so that they can plan their retirement with the confidence that their Social Security benefits will be there. This motivation for early action is even more important than the modest contribution that a Social Security fix will make to stabilizing the debt.

Medicare raises more complex issues than Social Security, but bipartisan compromise to slow Medicare growth without depriving seniors of needed health care is also possible. Indeed, sensible reforms of the Medicare reimbursement regime could lead the way to slowing the unsustainable growth of spending in the whole healthcare sector, relieving pressure on state, local, business, and family budgets—not just federal programs.

American health care is expensive compared to that in other developed nations and its quality is uneven. Part of the reason is that so much health care is compensated on a fee-for-service basis, which encourages providers to deliver more services, but does not reward quality, efficiency, or positive health outcomes. Medicare is the most important payer of health providers. It should be possible to shift the Medicare reimbursement regime toward bundled payments for episodes of care, reimbursement of Accountable Care Organizations, and capitated payments to integrated health systems—all designed to reward delivery of effective care, meeting quality standards, and keeping beneficiaries healthy.

There are two possible approaches to improving the performance of health providers along these lines. One is to change incentives in traditional Medicare by regulation. The other is to foster competition among health plans on a regulated exchange or market place. In the original Domenici-Rivlin plan we recommended doing both—improving traditional Medicare by regulation, but also introducing the option of competition among

integrated health plans in a premium support model. Subsequent analysis has suggested that it may be possible to introduce the competitive element more smoothly by ensuring that Medicare Advantage plans compete in a more transparent market place with effective incentives to improve health outcomes and lower costs. The recent slowing of healthcare spending suggests that it *may* be possible to keep the increase in spending close to the rate of growth of GDP without enforcing a cap.

Changing health care reimbursement and delivery practice will take time. That is why it must start soon if it is to make the necessary future contribution to stabilizing and eventually reducing the debt/GDP ratio.

Why Tax Reform Must Raise Additional Revenue

Even extremely successful efforts to deliver health care more efficiently and slow the growth of health spending will not make it possible to absorb the coming avalanche of seniors without additional revenues. Benefits for older people are already crowding out investment in knowledge and skills of young people and modernization of infrastructure needed to increase future productivity.

Our tax code contains enormous amounts of spending that is poorly designed for its ostensible purpose, disproportionately benefits upper-income people, and narrows the tax base. Reducing spending in the tax code could raise additional revenue at lower rates and make the tax system more progressive at the same time. Both Simpson-Bowles and Domenici-Rivlin recommended drastic comprehensive reform of both the individual and corporate income taxes to broaden the base and lower the rates.

The Domenici-Rivlin plan did away with almost all deductions, exclusions and other special provisions. It had two individual income tax rates—15 and 28 percent—gradually phased out the exclusion of employer-paid health insurance from taxable income, taxed capital and earned income at the same rates, converted the home mortgage and charitable deductions to credits at the 15 percent rate, and retained earned income and child credits. The result was a fairer, simpler, more pro-growth tax system that increased progressivity and raised more revenue. Such a drastic revamping of our current code would have multiple opponents, but might be easier to accomplish than a more incremental approach – which could have as many losers but no winners, without nearly as much of the potential benefit for the economy.

Importance of Both Growth and Debt Stabilization

Those of us who advocate near-term action to curb future debt increases have been called "debt scolds" and "deficit hawks." We have been unfairly accused of favoring immediate austerity and not understanding the need for accelerating job growth and improving productivity. But pursuing the double goal of growth and debt stabilization is possible, provided we get the timing right. We should not have austerity now, but we should take immediate steps to slow the growth of entitlement spending in the future and raise more revenue through a more progressive and pro-growth tax system.

Thank you, Mr. Chairman, Madam Vice-Chair and Members of the Committee.

BIPARTISAN POLICY CENTER

Domenici-Rivlin Debt Reduction Task Force Plan 2.0
Senator Pete Domenici and Dr. Alice Rivlin

In 2010, the Bipartisan Policy Center (BPC) convened a Debt Reduction Task Force (DRTF) of 19 former elected officials and experienced citizens with diverse backgrounds from across the political spectrum. We co-chaired the task force with the goal of addressing the projected explosion of U.S. federal debt. As we released our report, the National Commission on Fiscal Responsibility and Reform, led by former Sen. Alan Simpson and former White House Chief of Staff Erskine Bowles, also delivered their plan.

These bipartisan groups came to similar conclusions: First, the present debt trajectory of the United States federal government cannot be sustained and poses grave dangers to the American economy; second, policymakers must make difficult decisions to get our fiscal house in order; and third, any realistic solution must include structural reforms to entitlements and fundamental tax reform that raises significant new revenue.

These bipartisan proposals have increased awareness of the nation's severe fiscal problems. Further, Congress has passed components of these plans into law – most notably, the caps on annually appropriated spending contained in the Budget Control Act of 2011. But much work remains and that is why we are updating our proposals and renewing our effort with the release of Domenici-Rivlin 2.0.

No debt reduction plan can be sustained without strong and steady economic growth. The financial crisis caused a protracted economic downturn, and unemployment remains unacceptably high. We continue to believe that the economy needs additional near-term support. To that end, we recommend an immediate, large income tax rebate, similar in structure to those used in 2001 and 2008, to spur economic activity by putting money into the pockets of those most likely to spend it. Importantly, while we believe lawmakers must agree to a debt reduction plan in 2013, many of the provisions ought to be phased in over time as employment and economic growth return to more typical levels.

The Domenici-Rivlin Plan: Five Challenges

1. **Restrain defense and non-defense discretionary spending**

   Of the original recommendations from the Debt Reduction Task Force, this is the one area that Congress and the president have fully addressed. The caps placed on defense and non-defense discretionary spending – enacted as part of the Budget Control Act of 2011 – along with previous spending cuts, have placed discretionary spending on a path similar to that recommended by the Domenici-Rivlin plan (see Figure 1).

   Sequestration, which is scheduled to go into effect in January 2013, would slash discretionary spending far below the levels recommended by the Task Force, and thus, we believe that those cuts should be avoided as part of a comprehensive plan that addresses our remaining fiscal challenges.

   If policymakers wish to address discretionary spending further, they should reform the budget process. We recommend a regular, systematic analysis by Congress of each area of discretionary spending to identify those programs that deserve reauthorization and those that can be made more efficient. (For example, analysts from across the political spectrum have called for reform of procurement within the Department of Defense.) Such periodic reviews will improve the effectiveness and accountability of government.

2. **Promote short- and medium-term economic growth**

   Long-term fiscal sustainability requires reforming and cutting government spending programs, raising additional revenues, and spurring the economy to create more jobs and increase investment. Near-term growth can be boosted through a variety of stimulative policies, but few of them are likely to garner bipartisan support in the current polarized environment. We believe that an income tax rebate, similar in structure to those implemented in 2001 and 2008, could appeal to both parties and be effective. This one-time rebate, which should be similar in size to the expiring reduction in the payroll tax, will boost consumption and investment to accelerate the recovery. Of course, this and any other policies that add to the short-term deficit should be paired with a long-term debt reduction agreement rather than be enacted in isolation.

3. **Reform the corporate and individual tax codes by eliminating or curbing nearly all tax expenditures, reducing marginal rates, and raising significant new revenues for deficit reduction, while maintaining progressivity**

   Every plausible route to long-term fiscal sustainability includes substantial additional revenue. At the same time, however, we can reform the tax code to spur economic growth through a simpler system that stops picking winners and losers. The relevant congressional

committees should build broad, bipartisan support around such a reform.

4. **Reform health care entitlements to bend the cost curve, transitioning from volume-based reimbursement toward rewarding quality and positive health outcomes**

   We currently face immense budgetary pressures from the combination of rising per-capita health care spending and an aging cohort of baby boomers. To reduce the growing pressure on all budgets — federal, state/local, business, and household — we must control the growth of health care spending. Fee-for-service reimbursement, which dominates health care delivery, rewards volume of services rather than quality and effectiveness, and it leads to waste, duplication, and poor coordination of care. As the country's largest health care payers and spending drivers, Medicare and Medicaid urgently need reform and could help transform the whole health care system.

   Our proposal for Medicare (described in more detail below) improves the cost effectiveness of traditional Medicare through innovations in reimbursements and other incentives while strengthening competition among comprehensive, integrated health plans. Increasing competition and reducing government overpayments – using Medicare Advantage (MA) as a vehicle (through the application of competition among traditional Medicare and private MA plans) – can produce savings, while simultaneously improving quality and preserving the Medicare guarantee.

5. **Pass a balanced package of policies that achieves long-term solvency of Social Security**

   Social Security reform should not be approached from the vantage point of deficit reduction but rather with the goal of securing and strengthening a critical foundation for retirement for future generations. Without adjustments, the program will soon reach a point at which benefits must be slashed across the board or large transfers from general funds will be required. Accordingly, both parties in Congress should work with the president to adjust benefits and enhance revenues to set the program back on sound financial footing.

SPENDING CUTS AND REFORMS

The only realistic way to close the gap between how much the federal government spends and how much it collects is to reduce outlays and increase revenues. On the spending side, in addition to structural reforms to the major health entitlement programs, this requires sensible adjustments to nearly all discretionary and mandatory spending programs. Although we recommend that policymakers enact these changes as soon as possible, they should not take effect until 2014 or later so as not to damage the fragile economic recovery.

Domestic Discretionary. The Budget Control Act of 2011 (BCA) already imposed ten years of caps on this category of spending – reductions that are roughly consistent with the restraint recommended by our original Task Force plan. We do not feel that any additional cuts to this area would be prudent.

Defense. Similarly, the BCA also established ten years of caps on defense spending similar to the DRTF proposal. Experts from across the political spectrum believe that the procurement and retirement components of the U.S. defense budget require major reforms. We agree on the need for these changes, and believe that they can produce some additional savings from the Department of Defense. We do not believe, however, that they will provide major additional deficit reduction in the near term.

Health Care. Most of the nation's long-term fiscal imbalance is the result of unsustainable growth in health care costs. The federal government must play a significant role in health system change, not only to reduce budget deficits, but to help restrain the growth in health care costs and improve health care quality system-wide.

The centerpiece of our Medicare reform proposals is the Domenici-Rivlin Protect Medicare Act, which will establish competition on the basis of quality and price between traditional Medicare and Medicare Advantage plans. Public and private plans will compete in a well-regulated Medicare Exchange where the cost and quality of all plans will be presented clearly to beneficiaries.

The federal contribution will be based on the cost of the second-least-expensive plan or traditional Medicare, whichever is less expensive, and the growth of the per-beneficiary federal support will be capped at GDP + 1%. (Under current law, however, CBO projects costs to grow, on average, more slowly than that rate for the next two decades, in which case the cap would not come into play. In fact, we are confident that competition will save more than the cap will in the long run, and that the cap therefore will never bind.) The competition among plans could be introduced as part of a reform of Medicare Advantage.

Efficiency in the private sector will be encouraged by slowly phasing out the tax exclusion for employer-provided health benefits. This tax expenditure, in addition to being regressive, encourages expensive plans with inefficient cost-sharing, helping to drive unsustainable growth in health care costs.

We also propose a variety of reforms to Medicare, Medicaid, and other federal health programs to encourage greater efficiency, quality and consumer protections. In Medicare, we will modernize the benefit structure to have uniform cost-sharing and, for the first time, implement an out-of-pocket maximum to protect beneficiaries from catastrophic costs. We will end first-dollar supplemental coverage, increase Part B premiums over five years from 25 percent to 35 percent of total program costs, and use Medicare's buying power to reduce the program's drug costs. We will bundle Medicare payments for post-acute care to encourage care coordination and reward efficiency. In addition to deficit reduction, these cost savings can permanently replace the Sustainable Growth Rate (SGR) formula for Medicare physician payments.

We propose two major changes to Medicaid federal-state financing. We will replace the current matching funds system, in which the federal and state governments split the cost of care for different beneficiaries at different rates, with a single, blended rate for each state that will automatically rise in times of recession and decline in times of growth. We will bar states from gaming the system to collect matching funds based on provider taxes, which are invariably returned to the providers after the states spend the federal matching dollars.

Our other proposals improve parts of the health system where costs are particularly high. To address public health and the rising costs of obesity, we will establish a two cent per ounce excise tax on sugary beverages. We will cap medical liability awards for noneconomic damages and launch large-scale tests, including safe harbors for following professional guidelines and administrative claims processing systems. We will accelerate savings in the Medicare home health program and reduce special Medicare payments that cover bad debts, graduate medical education, and rural hospitals, all of which will benefit from expanded coverage from the Affordable Care Act. We will increase TRICARE premiums and drug copayments. We will limit Medicaid reimbursement for durable medical equipment to Medicare rates. Finally, we will crack down on "pay for delay" agreements that restrict access to generic drugs and shorten the exclusivity period for brand name biologics.

Other Mandatory Spending. Many other programs run on autopilot, with no recurring oversight by Congress. We propose reforms listed below to constrain the growth of these programs and improve their effectiveness:

- Implement a package of farm program reforms;

- Adjust the age at which career military can retire to be consistent with federal civilian retirement;
- Reform civilian retirement by calculating benefits based on a retiree's annual salary from his or her highest five years of government service, and increase employee contributions to the defined retirement benefit to be more consistent with the private sector;
- Raise fees for aviation security;
- Adopt a more accurate inflation measurement to calculate cost-of-living-adjustments (COLAs) for all federal programs;
- Cease production of dollar bills and the one-cent piece, while increasing production of dollar coins;
- Index mandatory user fees to inflation; restructure the power marketing administrations to charge market rates;
- Sell non-hydropower Tennessee Valley Authority electric utility assets to private investors;
- Reform the Postal Service; and
- Sell unneeded federal property.

Social Security. Our balanced package of policies achieves sustainable solvency, prevents the program from adding to the deficit in the coming decades, and, even more importantly, preserves and strengthens it for future generations. Changes include:

- Gradually raise payroll taxes to cover 90 percent of all wages;
- Use a more accurate calculation of annual COLAs (which applies to all indexed programs, including the tax code);
- Implement modest additional means testing for high-income beneficiaries;
- Increase the minimum benefit;
- Index the benefit formula for increases in life expectancy; and
- Cover newly-hired state and local workers under Social Security.

TAX REFORM AND REVENUE INCREASES

BPC's Tax Reform Plan radically simplifies the current tax code and raises approximately $1.6 trillion more than current policy (which is $2.9 trillion less than current law, with the expiration of all temporary tax cuts). To best explain it, forget what you know about the complex current tax system, and start fresh. Outlined below are the core elements of the plan. Unless otherwise indicated, all changes are implemented beginning in 2014.

- A **two-bracket income tax with rates of 15 percent and 28 percent**. Because there is no standard deduction or personal exemption, the 15-percent rate applies to the first dollar of income.[1]

- The **corporate tax rate will be a flat 28 percent**, instead of the current 35 percent top rate.

- Capital gains and dividends will be taxed **as ordinary income (with a top rate of 28 percent)**, excluding the first $1,000 of realized net capital gains (or losses).[2]

- To replace the overly-complex Earned Income Tax Credit (EITC) and the personal exemptions, the standard deduction and the child credit, the BPC Plan will:
  - Establish a flat **refundable per child tax credit of $1,600** (higher than current law);
  - Retain the **child and dependent care credit**; and
  - Establish a **refundable earnings credit**[3] similar in structure to the recent Making Work Pay credit, but substantially larger.

- Instead of the current system of itemized deductions, which disproportionately subsidizes the housing and charitable giving of upper-income taxpayers, the BPC Plan will:
  - Provide a **flat 15-percent refundable tax credit for charitable contributions** and for up to $25,000 per year (not indexed) **mortgage interest on a primary residence**. (These refundable credits will begin at 20 percent in 2014, and then phase down to 15 percent over five years.)
  - Eliminate the deduction for state and local taxes.
  - Provide a flat, **15-percent refundable tax credit** or a deduction (for those in the higher bracket) **for contributions to retirement savings accounts** up to 20 percent of earnings or a maximum of $20,000.

- Include 100 percent of Social Security benefits in taxable income, but:
  - Create a non-refundable credit for Social Security beneficiaries equal to 15 percent of the current standard deduction; and

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[1] The 28% rate applies approximately to income above $51,000 for single filers and $102,000 for couples.
[2] $500 for singles and heads of household
[3] The refundable earnings credit is equal to 17.5% of the first $20,000 of earnings.

- Create a non-refundable credit equal to 15 percent of an individual's Social Security benefits.

- Effective in 2015, cap and then phase out over 10 years the tax exclusion for employer-sponsored health insurance benefits.

- Limit the deduction for medical expenses to the amount exceeding 10 percent of adjusted gross income (AGI) (unchanged from current law).

- Limit miscellaneous itemized deductions to the amount exceeding 5 percent of AGI (increased from 2 percent in current law).

- Increase the gas tax by 15 cents and index it to inflation, dedicating the revenue to the highway trust fund.

- Increase taxes on tobacco and alcohol.

The BPC Tax Reform Plan enormously simplifies the tax code by **aligning the top individual, capital gains and dividend tax rates with the significantly-reduced corporate tax rate, while eliminating the Alternative Minimum Tax**. Additionally, **most individuals will no longer have to file an annual tax return**[4] beyond an initial declaration of status because the most commonly taken deductions are either converted into refundable credits, determined solely based on the number of children and earnings, or can be deducted only above a substantial floor. Despite a low top rate of 28 percent, the BPC tax system will increase progressivity and will **raise the requisite revenue to achieve our debt-reduction goal.**

[4] According to Tax Policy Center projections, only 50% of tax units would be required to file tax returns, as opposed to 88% under the current tax system.

CONCLUSION

This updated BPC Domenici-Rivlin deficit reduction plan addresses the nation's fiscal problem with a balanced and workable approach. Our plan shows that the challenge can be met if lawmakers demonstrate leadership and put everything on the table. The changes we suggest are not easy, but they improve the quality and efficiency of government and strengthen the economy for all Americans.

The experience of BPC fellows and staff – former elected officials, cabinet secretaries, business leaders, senior congressional staff members, and senior executive branch officials – informs our recommendations, which also benefit from the work of the Congressional Budget Office and other experts. But despite literally millions of words deployed on analysis, legislative proposals, and recommendations, the policy changes to achieve fiscal sustainability and strengthen the American economy have not yet been made.

The nation needs substantial fiscal reforms no later than the first session of the 113th Congress. BPC has proposed a legislative framework to be enacted this year to facilitate a 2013 agreement, which could be similar to the Domenici-Rivlin proposal. To provide the time lawmakers need to reach a comprehensive agreement, the fiscal cliff (automatic spending cuts and tax increases scheduled to take effect in January 2013) should be replaced with a more realistic backstop that will guarantee $4 trillion in deficit reduction if Congress fails to act by the end of 2013. The framework limits procedural delays and removes supermajority requirements that could prevent an agreement. To show good faith, Congress should add to the framework a combination of initial spending cuts and revenue increases that offset part of the cost of addressing the fiscal cliff.

Time is running out. The election is over. The options are clear. Now our leaders must show the courage to take risks and make hard decisions, and the American people should support those who do. We stand ready to help.

Appendix: Tax Expenditures Retained in the New Tax Structure

401(k) plans, Individual Retirement Accounts, and Keogh plans, but the total amount employees and employers may contribute to tax-deferred retirement saving plans is limited to the smaller of 20 percent of earnings or $20,000.

Accelerated depreciation of buildings other than rental housing (normal tax method)

Accelerated depreciation of machinery and equipment (normal tax method)

Capital gains exclusion on home sales

Carryover basis of capital gains on gifts

Deductibility of casualty losses

Deductibility of charitable contributions is replaced by a 15 percent refundable credit for contributions that all taxpayers may claim.

Deductibility of medical expenses

Deductibility of mortgage interest on owner-occupied homes is replaced with a refundable credit of 15 percent for the first $25,000 of mortgage interest paid that all homeowners may claim. The new credit is limited to principal residences.

Deferral of income from controlled foreign corporations (normal tax method)

Deferral of interest on U.S. savings bonds

Deferred taxes for financial firms on certain income earned overseas[5]

Employer defined-benefit retirement plans

Exclusion of benefits and allowances to armed forces personnel

Exclusion of interest on public purpose state and local bonds

Exclusion of interest spread of financial institutions

Exclusion of net imputed rental income

Expensing of certain small investments (normal tax method)

Expensing of research and experimentation expenditures (normal tax method)

Income averaging for farmers

Low and moderate income savers credit is expanded. In place of a deduction, taxpayers may claim a 15 percent refundable credit. This helps those in the 15 percent bracket with no liability.

Ordinary income treatment of loss from small business corporation stock sale

Tax credit for the elderly and disabled, and additional deduction for the elderly and blind are replaced with a new tax credit for those 65 and over or blind.

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[5] The Task Force plan leaves in place the provision that allows U.S. multinationals to defer taxation of the profits of their foreign subsidiaries until those profits are repatriated to the U.S. parent (deferral). Some view deferral as an incentive for U.S.-based companies to invest overseas, but others believe eliminating deferral would damage the ability of U.S. corporations to compete with foreign-based corporations and note that most of our major trading partners have enacted territorial systems that exempt completely the active foreign income of their corporations. While the Task Force plan does not address our complex system of taxing international income flows of corporations, the substantially lower corporate tax rate that the Task Force proposes will increase the incentive for both U.S. and foreign-based multinationals to invest in the United States.

BIPARTISAN POLICY CENTER'S DOMENICI-RIVLIN 2.0

	Fiscal Years, Billions of $							Cumulative Savings:		
	2013	2014	2015	2016	2017	2018	2019	2013-2022	2013-2032	2013-2042
1. Current Debt Projections (debt held by the public)										
In billions of dollars	12,354	13,223	13,966	14,709	15,448	16,193	17,050	20,149	41,178	90,201
As a percent of GDP	73%	78%	81%	80%	79%	78%	78%	81%	109%	155%
HEALTH CARE SAVINGS - BENDING THE COST CURVE										
2. Cap employer-sponsored health insurance exclusion in 2015 and phase-out over 10 years (net effect on deficit)	0	1	12	0	-15	-37	-64	-460	-2,576	-6,224
Medicare Savings:										
Near Term:										
3. Raise Part B premiums from 25% to 35% of program costs (over 5 years)	0	-5	-11	-18	-26	-34	-37	-263	-966	-2,330
4. Modernize Medicare's benefit structure and provide catastrophic coverage / Medigap reform	0	-7	-10	-10	-10	-11	-12	-102	-322	-749
5. Post-Acute bundling (mandate instead of pilot)	0	0	0	-3	-3	-3	-3	-25	-85	-203
6. Require minimum Part D Rebate	0	-7	-11	-13	-13	-15	-18	-142	-516	-1,242
7. TRICARE: Introduce min out-of-pocket requirements	0	-1	-1	-1	-1	-1	-1	-11	-34	-81
8. Shorten exclusivity for brand name biologic drugs	0	0	0	0	0	0	0	-3	-13	-34
9. Prohibit pay for delay	0	0	0	0	0	-1	-1	-4	-15	-35
10. Reduce graduate medical education expenses (Includes IME)	0	-5	-6	-6	-7	-7	-8	-65	-204	-476
11. Reduce subsidies to rural hospitals	0	0	0	0	0	0	0	-2	-6	-15
12. Accelerate home health savings from ACA	0	-1	-1	-1	-1	-1	-2	-9	-9	-9
13. Reduce coverage of bad debts	0	0	-1	-1	-2	-2	-2	-16	-56	-134
14. Reform QIOs	0	0	0	0	0	0	0	-3	-13	-32
15. **Long Term:** Convert to Defined Support in 2016 utilizing competitive bidding, with growth per beneficiary capped at GDP+1%	0	0	0	-30	-32	-34	-38	-274	-1,483	-4,857
Total Medicare Savings (including interactions)	**0**	**-27**	**-42**	**-82**	**-92**	**-105**	**-117**	**-888**	**-3,704**	**-10,265**

	Fiscal Years, Billions of $							Cumulative Savings:		
	2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2013-2022**	**2013-2032**	**2013-2042**
Medicaid Savings:										
16. Phase down provider tax threshold beginning 2015	0	0	-3	-4	-6	-6	-7	-48	-158	-351
17. Limit Medicaid DME reimbursement	0.0	-0.1	-0.1	-0.2	-0.3	-0.3	-0.4	-3	-9	-21
18. Apply single blended matching rate to Medicaid/CHIP	0	0	0	0	-3	-3	-3	-18	-60	-133
Total Medicaid Savings	**0**	**0**	**-3**	**-5**	**-10**	**-10**	**-10**	**-69**	**-227**	**-504**
19. Medical malpractice reform	0	-1	-3	-6	-8	-9	-10	-70	-241	-556
SUBTOTAL: Health Care Savings (including interactions)	**2,013**	**1,959**	**1,934**	**1,834**	**1,787**	**1,738**	**1,686**	**-1,487**	**-6,748**	**-17,548**
STRENGHTEN SOCIAL SECURITY FOR FUTURE GENERATIONS										
Revenue:										
20. Increase taxable base to 90% over 36 years (begin in 2014)	0	0	8	14	17	20	22	192	730	1,942
21. Cover state and local workers (beginning in 2020) and share pension info w/ state & local govt's	0	0	0	0	0	0	0	13	194	710
Benefits:										
22. Index benefit formula for longevity (begin in 2023)	0	0	0	0	0	0	0	0	-29	-355
23. Change to more accurate annual COLA calculation	0	-2	-4	-7	-10	-13	-16	-123	-621	-1,643
24. Adjust benefit formula (protecting bottom 75% - 15% replacement rate goes to 10% over 20 years and create new 8% bend point, beginning in 2023)	0	0	0	0	0	0	0	0	-10	-83
25. Update minimum benefit for long-term low-wage earners and protect the most vulnerable elderly with a modest benefit increase	0	5	7	8	9	10	11	91	308	756
SUBTOTAL: Social Security Savings (including interactions)	**0**	**5**	**11**	**16**	**21**	**26**	**30**	**-238**	**-1,278**	**-3,994**

	Fiscal Years, Billions of $							Cumulative Savings:		
	2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2013-2022**	**2013-2032**	**2013-2042**
OTHER ENTITLEMENT (MANDATORY) SAVINGS										
26. Reform federal civilian and military retirement	0	-2	-6	-11	-12	-13	-14	-107	-337	-739
27. Change to more accurate annual inflation adjustment for federal benefit programs	0	0	-1	-1	-2	-2	-3	-21	-107	-318
28. Modernize farm programs	0	-2	-3	-4	-4	-4	-4	-37	-102	-208
29. Increase fees for aviation security	0	-2	-2	-2	-2	-2	-2	-19	-44	-74
30. Restructure the Power Marketing Administration to charge market-based rates	0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-2	-5	-8
31. Transfer the Tennessee Valley Authority's electric utility functions and associated a	0.0	0.0	0.0	-0.1	-0.5	-0.5	-0.5	-3	-8	-13
32. Replace the dollar bill with a $1 coin and stop production of pennies	0.0	-0.1	0.1	0.0	-0.1	-0.6	-0.3	-2	-6	-10
33. Increase cost sharing for pharmaceuticals under TRICARE	0.0	-0.5	-1.0	-1.1	-1.2	-1.4	-1.5	-12	-40	-94
SUBTOTAL: Other Mandatory (including interactions)	**0**	**-8**	**-13**	**-20**	**-22**	**-24**	**-26**	**-202**	**-646**	**-1,457**
FUNDAMENTAL TAX REFORM										
34. Income tax rebate to spur economy in 2013	-90	-30	0	0	0	0	0	-120	-120	-120
35. BPC Tax Reform Plan (net new revenues)[1]	-17	-86	61	104	146	195	247	1,664	7,707	22,533

1) The effects of policies # 2, 20, and 21 are included in "35. BPC Tax Reform Plan (net new revenues)."

	Fiscal Years, Billions of $							Cumulative Savings:		
	2013	2014	2015	2016	2017	2018	2019	2013-2022	2013-2032	2013-2042
TOTAL: SPENDING POLICY REDUCTIONS (excluding already enacted savings)	0	33	58	111	133	151	168	1,261	5,172	14,124
TOTAL: NET NEW REVENUES	-107	-116	61	104	146	195	247	1,544	7,587	22,413
TOTAL DEBT SERVICE SAVINGS	0	-1	0	2	9	23	41	342	4,434	19,802
TOTAL DEBT REDUCTION	-107	-83	119	217	288	369	456	3,147	17,193	56,339

								In Year:		
	2013	2014	2015	2016	2017	2018	2019	2022	2032	2042
Bipartisan Plan Debt as % of GDP	79%	82%	81%	78%	76%	74%	73%	69%	63%	58%
Baseline Debt as % of GDP	78%	81%	80%	79%	78%	78%	78%	79%	109%	155%
Bipartisan Plan Deficit as % of GDP	-6.6%	-5.2%	-3.0%	-2.3%	-1.8%	-1.4%	-1.5%	-1.4%	-2.2%	-1.6%
Baseline Deficit as % of GDP	-5.9%	-4.7%	-3.7%	-3.5%	-3.2%	-3.2%	-3.6%	-4%	-8%	-11%
Bipartisan Plan Outlays as % of GDP	22.7%	22.2%	21.6%	21.4%	21.2%	21.1%	21.4%	22.1%	23.8%	24.6%
Baseline Outlays as % of GDP	22.7%	22.4%	21.8%	21.9%	21.7%	21.7%	22.1%	22.4%	26.8%	30.3%
Bipartisan Plan Revenue as % of GDP	16.1%	16.9%	18.6%	19.1%	19.4%	19.7%	19.9%	20.7%	21.6%	23.0%
Baseline Revenue as % of GDP	16.8%	17.6%	18.2%	18.4%	18.5%	18.5%	18.6%	19%	19%	19%

Economic Implications of the Fiscal Outlook

Testimony presented to the
U.S. Congress
Joint Economic Committee

Douglas Holtz-Eakin, President*
American Action Forum

March 14, 2013

*The views expressed here are my own and do not represent the position of the American Action Forum. I thank Gordon Gray, Cameron Smith, and Tiffany Wen for tremendous assistance in preparing this testimony.

Introduction

Chairman Brady, Vice-Chairman Klobuchar and members of the Committee, I am pleased to have the opportunity to appear today. In this testimony, I wish to make three basic points:

- The level and projected growth of federal debt is a drag on current U.S. economic growth and a threat to future prosperity,
- The scale of needed debt reduction dwarfs the impending sequester and associated discretionary caps in the Budget Control Act, and
- A superior strategy for debt control and economic growth is to control the scale of spending, and pair entitlement reform with pro-growth tax reform.

I will pursue each in additional detail.

The Economic Consequences of Federal Debt

Earlier this month, the Congressional Budget Office (CBO) released its Budget and Economic Outlook for 2013-2023. This release is particularly significant. For the first time in over ten years, the current-law baseline offers a fairly reasonable projection of the nation's current budget policy over the next decade. With the enactment of the so-called "fiscal cliff" tax deal, current tax law is relatively stable – that is, largely free of scheduled expirations that are regularly overturned. On the spending side, the discretionary caps under the Budget Control Act of 2011 (BCA) give a realistic pathway for annual appropriations. Mandatory spending is, of course, guided by current law with the overall result that current law provides a good depiction of current budgetary intent over the next decade.

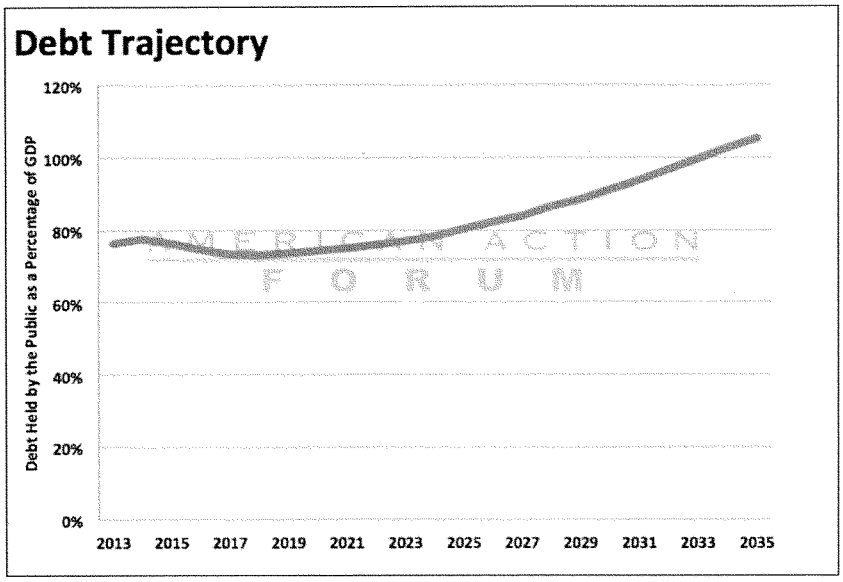
One would hope that outlook would reveal that existing deficit reduction measures (the BCA and the tax increases embedded in the American Taxpayer Relief Act (ATRA)) have improved the federal government's finances. Unfortunately, CBO's baseline confirms that the nation, despite and claims to the contrary, remains on a damaging debt pathway.

The Debt Trajectory (2013-2035)

Under current law debt held by the public – measured as a fraction of Gross Domestic Product (GDP) – will temporarily shrink during the ten-year budget window. Some will suggest that the absence of immediate and additional severe debt accumulation in the near-term provides the nation the freedom to forgo meaningful debt reduction. This ignores the fact that the debt outlook is but a temporary reprieve, as the debt burden begins to rise toward the end of the budget window. A conservative medium-term projection reveals that the debt held by the

public will continue to spiral upward and reach 105 percent of GDP by 2035 (see Figure 1).[1]

Figure 1:



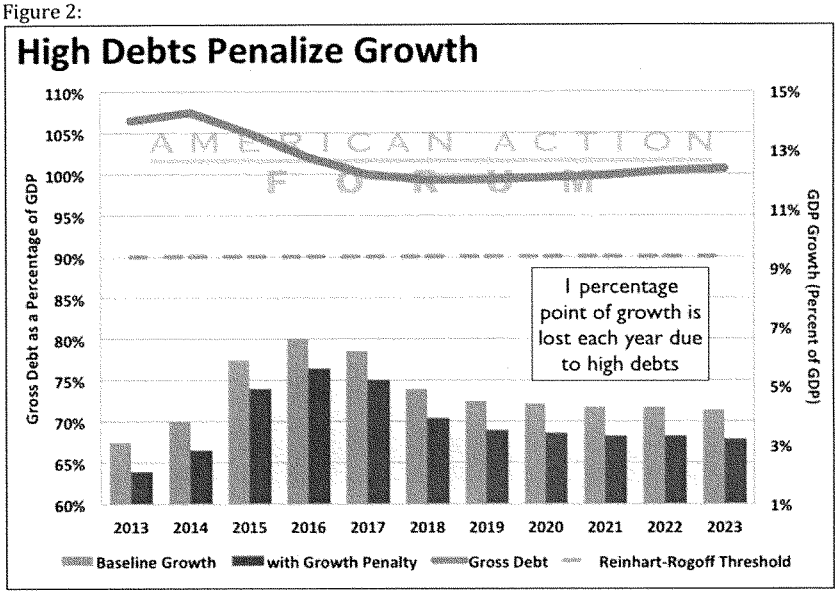
Federal Debt is a Drag on the Economy
It is often asserted that the economic downside to the level and projected excessive federal debt is a distant threat; indeed, that it is even more economically damaging to address the debt explosion than to accommodate it. This reasoning is 180 degrees from reality, as the U.S. is already paying an economic price for the excessive federal debt.

Research of Carmen Reinhart and Kenneth Rogoff – based on a careful empirical analysis of 44 countries over the past two centuries – indicates that when gross government debt (as a percent of GDP) exceeds 90 percent, median growth is roughly 1 percentage point lower annually than for comparable countries with lower debt burdens.[2]

[1] AAF calculations. Details available upon request.
[2] http://www.economics.harvard.edu/faculty/rogoff/files/Growth_in_Time_Debt.pdf

Gross federal debt already exceeds 100 percent of U.S. GDP, and under current law gross debt will remain above 90 percent over the entire 2013-2023 period.[3] Applying the research rule of thumb indicates that the U.S. is right now paying a persistent growth penalty of 1 percentage point per year (see Figure 2). Accordingly, debt reduction is no mere arithmetic exercise – it is an economic imperative. Continued high levels of indebtedness will slow annual economic growth, and therefore slow job creation and wage growth.

Figure 2:



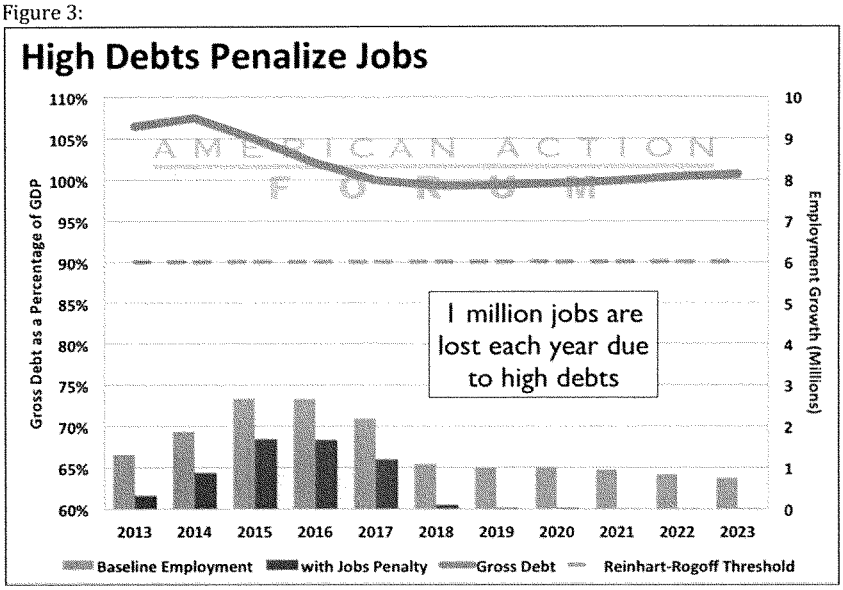
The administration has estimated that one percentage point in growth translates into approximately 1 million jobs created.[4] Accordingly, over the period in the CBO baseline, a persistent 1 percentage point growth penalty should translate into an annual penalty of 1 million jobs forgone – or 11 million jobs over 2013-2023 (see Figure 3).

Slower job creation is only one metric of the price the U.S. is paying for its excessive federal debt. Over 2013-2023, CBO estimates growth of wages and salaries to average about 5 percent. Median household income was $50,054 in 2011.[5] Under

[3] Gross federal debt is larger than the debt in the hands of the public. I focus on it in what follows to permit comparisons with the published research.
[4] http://www.politico.com/pdf/PPM116_obamadoc.pdf
[5] http://www.census.gov/prod/2012pubs/p60-243.pdf

CBO's projections, this should exceed $86,000 by 2023. Assuming a growth penalty of 1 percent, however, indicates that this income growth would be penalized by as much as $9,390 by 2035 under current law (see Figure 4).

Figure 3:



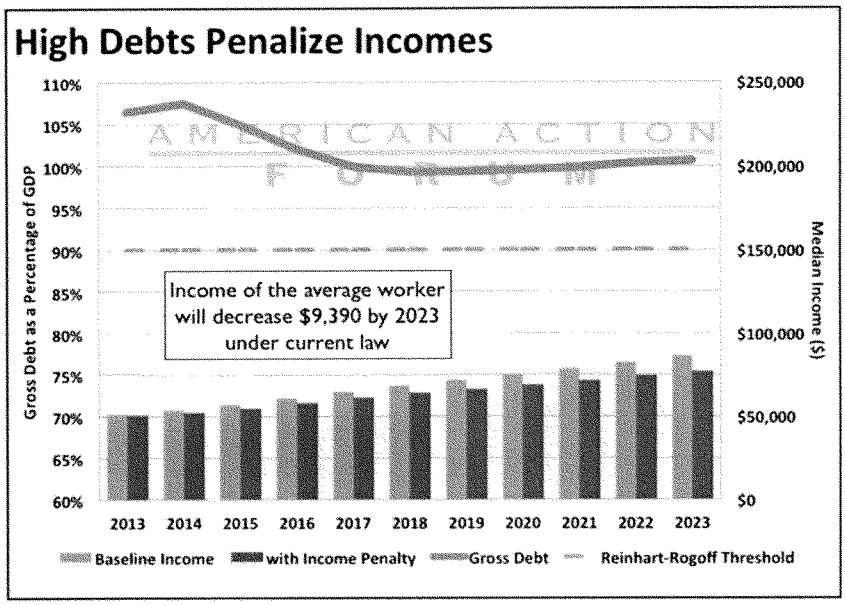
The Mechanisms of Slower Growth

One question that arises is the mechanism by which the deleterious growth effects occur. This is far from mysterious. In the worse case, a nation might be unwilling to undertake the tax and spending changes needed to stabilize its debt. A conscious strategy to sail straight toward a financial crisis would alarm small firms, large firms, and investors alike. Their unwillingness to hire, expand, and start new firms would immediately hamper growth.

Alternatively, the strategy might be dominated by an unwillingness to control spending and instead a commitment to dramatic tax increases as the means of reducing deficits and debt. The deleterious growth effects of anticipated sharply lower returns to work, saving and investment will become immediately apparent. These estimated penalties to growth, employment, and income penalties from high debt include the budgetary impacts of higher tax rates, lower discretionary spending, and the sequester enacted in recent years. The obvious conclusion is that additional deficit reduction is needed to avoid debt-driven economic stagnation.

There exist, however, important disagreements over just how much further deficit and debt reduction should be pursued.

Figure 4:

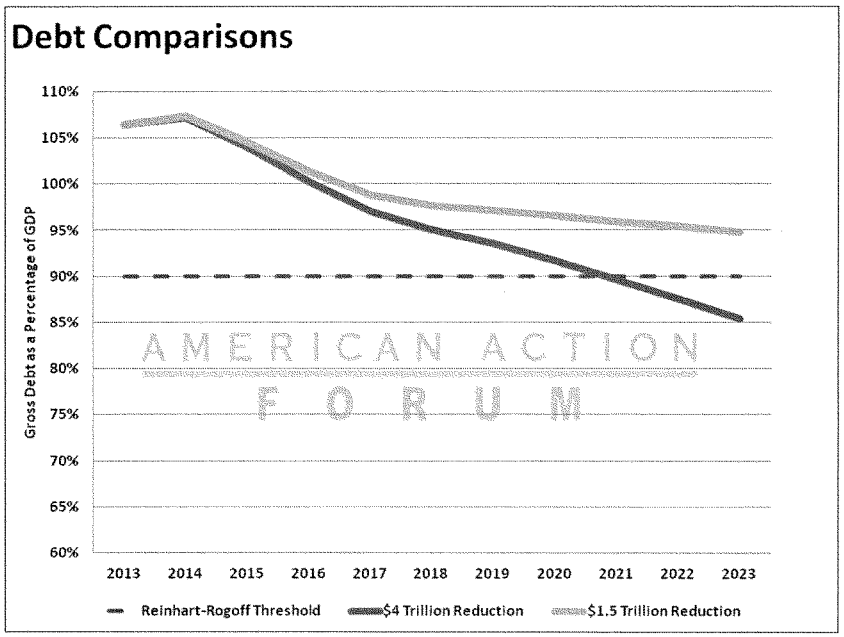


Targets for Debt Reduction

What is the right target for debt reduction? Many recent discussions on additional debt reduction have focused on "stabilizing" the debt as a share of GDP. That would be a sensible goal if it is stabilized at a level that is manageable and does not pose risks to the economy. Unfortunately, as noted above, the gross debt is currently above those levels – 90 percent of GDP. Stabilizing at or near the current levels of debt is a commitment to a future of slower growth and impending financial crisis.

A more sensible would be to reduce the debt to below the empirically observed threshold of 90 percent of gross debt as a share of GDP, thereby reducing the risk of financial crisis and stagnant growth. For example, choosing a gross debt-to-GDP ratio of 85 percent would require approximately $4 trillion in additional deficit reduction over ten years (see figure 5).

Figure 5



In addition to maintaining the current anti-growth effects of high debt, any plan to merely stabilize the debt within ten years would contribute to a failure to restrain debt accumulation over the medium and long-term. The stability promised by a more modest (for example, $1.5 trillion in 10 years) deficit reduction plan would persist for only a single year beyond the ten-year budget window. Thereafter, the debt would grow as a share of the economy to 87 percent by 2035 (see Figure 6).

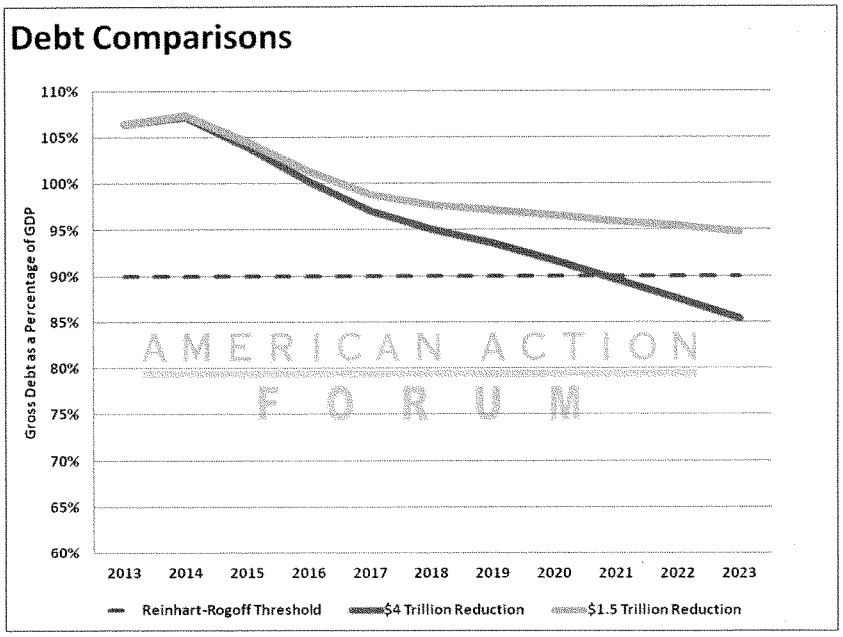
This is significant from a risk-management perspective. The longer that debt is preserved at high levels, the longer the risk remains that the United States would be vulnerable to a fiscal crisis.

Risk Management Issues and Debt Projections

The economic projections underlying the CBO baseline assume real GDP growth of 2.7 percent and 10-year interest rates of 4.4 percent over the next ten years. Plans to stabilize the debt-to-GDP using this projection are vulnerable to downside risks that would worsen the nation's debt outlook, and contribute to the well-understood mechanics of a fiscal spiral.

Slower growth or higher interest payments would be followed by higher debt, slower-yet growth, higher-yet interest rates and so on. Moreover, preserving debt held by the public at above 70 percent of GDP (or 100 percent in gross terms) leaves no cushion to absorb other adverse geopolitical or natural events. It assumes on can take comfort in the razor-thin margins embedded in necessarily- inexact projections.

Figure 6



Importantly, even a "stable" deficit reduction plan for the next 10 years does not contain the growth of the debt beyond the ten-year window.

Sequestration: A bad idea whose time has come

Of lesser consequence than the broader fiscal outlook, but perhaps greater immediacy, is the recently enacted sequester. The automatic enforcement mechanism of the failed "Super-Committee's" goal $1.2 trillion in deficit reduction is an admittedly blunt budgetary policy that is a poor substitute for meaningful reform, but is preferable to no spending reduction at all.

First, there is a need to demonstrate that spending will actually be controlled. CBO estimated that the discretionary spending caps in the BCA would reduce spending by $756 billion over ten years, exclusive of debt service.[6] However, these are only promises of reductions – they contain no programmatic changes that would guarantee lasting deficit reduction. Will these really occur?

Indeed, this past year has already seen Congress and the Executive branch willing to exceed the statutory caps for security spending, and supplement expenditures for Hurricane Sandy will increase budget authority by over $50 billion in FY 2013.[7] This increase nearly matches the entirety of the funding reduction of $62 billion in FY2013 attributable to the discretionary caps imposed by the BCA, as estimated by CBO. I point this out only to emphasize that promised deficit reduction in the absence of programmatic change is ephemeral. CBO has echoed this sentiment, noting that "holding discretionary spending within the limits required under current law might be difficult...the original caps on discretionary budget authority established by that legislation would reduce such spending to an unusually small amount relative to the size of the economy."

Sequestration will reduce the deficit modestly this year. Going forward, the mechanics of this automatic enforcement mechanism – essentially tighter discretionary caps married to a mandatory sequester – may only worsen the challenge of maintaining the discretionary caps. However, in the near term, the sequester will reduce outlays by $44 billion this year.

A second issue is the impact on government services. These impacts are real and we are beginning to hear about potential service disruption. To the extent practicable, agencies should be allowed to mitigate service disruption through prioritization, but some diminution of federal services should be expected. The potential disruption to federal agencies is not insignificant, but also not insurmountable.

The final issue is the impact on economic growth. Obviously, I believe it is imperative to control the debt and that this will have beneficial impacts. At the same time, the near-term impacts of the sequester are far less consequential than many have portrayed. The sequester is an $85 billion (roughly $44 billion in actual outlays) cut in a $3.6 trillion annual budget in a $16 trillion economy. That is a slice representing one half of one percent of the pie. Economic calamity will not ensue.

The economy is growing at about $630 billion per year. For the sequester to wipe out economic growth – as some rhetoric suggests – it would have to create roughly 7 times its size in economic impact, which far exceeds any realistic estimate of the size of economic multipliers.

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[6] http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/123xx/doc12357/budgetcontrolactaug1.pdf
[7] http://www.cbo.gov/sites/default/files/cbofiles/attachments/SummaryDRAppropAct2013-HR152-PassedHouse.pdf

Stepping back, the same Keynesian paradigm that emphasizes the near-term impacts of the sequester places a focus on the overall policy-induced changes in both taxes and spending. It seems incomplete at best to focus on the sequester when the ATRA imposes even larger tax burdens.

Thus, a more comprehensive estimate predicts modest near-term effects, that cannot be disentangled from the other policy decisions made this year. A reduction in federal expenditures now will add some impact to the ATRA effects on the economy. Even so, it is important to recognize the need for some near term reduction in current spending to offset the impact on economic growth that is risked by higher debt.

Better Strategies for Debt and Growth

As noted above, the nation faces a significant debt challenge, and existing measures to address it, though necessary, are inadequate. Removing the sequester would avoid some near-term discomfort, but the fiscal challenge confronting the United States is daunting and failure to address it in a credible way would likely generate negative economic effects. The CBO noted "eliminating or reducing the fiscal restraint scheduled to occur next year without imposing comparable restraint in future years would reduce output and income in the longer run relative to what would occur if the scheduled fiscal restraint remained in place." It is therefore necessary to pair any mitigation of near-term fiscal tightening with meaningful budget restraint in future years.

The essence of a better strategy is to pair the entitlement reform with tax reform, thereby controlling the underlying source of debt explosion and supporting the most rapid pace of economic growth possible. As an example, the American Action Forum has formulated *Balanced,* a plan to navigate these duel challenges. *Balanced* reflects the principle that the United States is served best by a contained, efficient government focused on core national security and domestic activities, including a durable social safety net. It is guided by the lesson of history that the best approach to simultaneous poor growth and explosive debt is to keep taxes low, reform taxes to be more pro-growth, preserve core functions of government, and focus on transfer programs – entitlement programs in the United States – as the route to controlling debt.

Balanced includes several key priorities that reflect the right balance of near-term growth considerations and longer term debt challenges.

Fundamental Tax Reform

While the "fiscal cliff" tax deal established some degree of permanence to the tax code, it did little to otherwise improve it. Rather, it locked in higher rates and a narrower base than is optimal. Looking past the current tax code, there is wide agreement that the U.S. corporate tax is an international outlier and in need of reform. The end-of-year tax agreement left this outlier untouched.

Balanced incorporates a fundamental tax reform that would move the U.S. to a progressive consumed-income tax code. This plan would be pro-growth and not penalize savings and investment. Research suggests that implementing a progressive consumed-income tax consistent with AAF's tax plan would improve long-run economic growth by over 6 percent.[8]

Reprioritize the Sequester in Favor of Entitlement Reform
The sequester has been widely acknowledged as poor policy – a failed "stick" to induce more substantive reforms that the "Super-Committee" ultimately failed to deliver. *Balanced* would reprioritize sequestration with more lasting, mandatory savings through programmatic reforms.

Balanced takes on the budgetary challenge by reforming the projected growth in mandatory spending programs, specifically health and retirement entitlements. Accordingly, major reforms focus on these areas of the federal budget. Future social security benefits are reformed to reflect price, rather than wage growth, while a premium support model is phased into Medicare for future retirees. Medicaid is reformed to reflect cost efficiencies achievable through competitive bidding.

Balanced includes additional reforms to other major areas of spending. The plan keeps discretionary spending slightly above current law. However, the plan includes a repeal of the overreaching and broken Affordable Care Act.

Taken together, these changes would set forth a credible and gradual improvement in the U.S. fiscal position. The American Action Forum plan achieves balance in 2031, with debt to GDP of 60.2. Over the long term, the AAF plan pays down the debt going from 77.6 percent of GDP (in FY2013) to 40.1 by 2037. These are far better budgetary outcomes than those contemplated in either current law or modest deficit reduction plans, but through the right policy choices – fundamental tax reform paired with entitlement reform – are eminently achievable and would leave future generations with a higher standard of living, rather than a legacy of debt and poor economic growth.

Obviously, I have a preference for the proposals developed at AAF. However, more important than the particulars are a strategy that shifts the focus of spending control to the needed entitlement reforms and shifts the debate on taxes away from harmful higher marginal tax rates in favor of pro-growth tax reform.

Thank you for the opportunity to appear today. I look forward to answering your questions.

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[8] David Altig, Alan J. Auerbach, Laurence J. Kotlikoff, Kent A. Smetters, and Jan Walliser, "Simulating Fundamental Tax Reform in the United States," American Economic Review, 91(3), June 2001, pp. 574-595.

Testimony submitted to Joint Economic Committee of Congress, hearing on "Flirting with Disaster: Solving the Federal Debt Crisis," March 14, 2013 (embargoed until 9:30am).

Submitted by Simon Johnson, Ronald Kurtz Professor of Entrepreneurship, MIT Sloan School of Management; Senior Fellow, Peterson Institute for International Economics; co-founder of http://BaselineScenario.com; member of the CBO's Panel of Economic Advisers; member of the FDIC's Systemic Resolution Advisory Committee; and member of the Systemic Risk Council.[1]

A. Main Points

1) A sudden move towards further tightening fiscal policy in the U.S. would undermine our economic recovery and has the potential to destabilize financial markets. We are moving in a precipitate manner towards an excessive and inappropriate degree of immediate austerity.

2) Now is a good time to discuss longer-term issues that will drive budget outcomes in future decades, particularly the paramount importance of the likely rising cost of healthcare (meaning all healthcare costs, not just those paid by the government). But this potentially sensible debate about healthcare has become very confused.

3) For example, significantly cutting federal discretionary domestic spending below current projected levels will weaken our education system, undermine our future human capital, and further fray our physical infrastructure – i.e., actually reduce attainable growth rates in the United States. This is not a good time to squeeze the provision of essential public goods.

4) There is no meaningful evidence that we "need" to cut federal deficits dramatically this year or next year or even over the next five years. It is far more important to get the economy back onto a sustainable growth path – and this includes not disrupting the private sector with damaging or disruptive public spending cuts.

5) The ongoing sequester is a perfect example of how not to manage fiscal policy. Combined with repeated confrontations over the debt ceiling and the possibility of a government shutdown, arbitrary and across the board cuts are hardly likely to help boost growth either in the short-term or the longer-term. Nor do they help boost confidence in the private sector.

6) More broadly, the rhetoric around supposedly "excessive" government spending has itself become excessive. The long-standing project to shrink the federal government – sometimes known as a strategy of "starve the beast" – has reached a new and very dangerous phase.[2]

7) To be precise, the disaster with which we now flirt is that we will inflict upon ourselves unnecessary and damaging austerity. We should instead be building an economy within which federal revenue can be robust and public spending growth can be contained over the next decade. A separate, but very important, issue is how to limit healthcare spending as a percent of GDP over the next 20-50 years.

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[1] This testimony draws on *White House Burning: The Founding Fathers, Our National Debt, and Why It Matters to You* (Pantheon, 2012), co-authored with James Kwak. Underlined text indicates links to supplementary material; if necessary, please access an electronic version of this document, e.g., at http://BaselineScenario.com. The Systemic Risk Council is a private group founded and chaired by Sheila Bair. All views expressed here are personal.

[2] For more historical background and relevant details on the development of this strategy since the 1970s, see Chapter 3 in *White House Burning*.

B. Do We Have a "Fiscal Crisis"?

Standard solvency analysis – including, for example, the tools used by the International Monetary Fund – confirms there is no prospect of an immediate fiscal crisis in the United States. We currently have "fiscal space", in the sense here is strong global demand for Treasury obligations in the foreseeable future.[3]

Long-term interest rates are low and remarkably stable. Partly this is due to actions by the Fed through various forms of "quantitative easing", but U.S. government securities are also seen as a safe haven for international investors. However, this safe haven status will be jeopardized if markets perceive a significant probability that we will not pay our debts as contracted – or if we create the perception that our economy will be thrown into repeated turmoil through regular showdowns over the debt ceiling or through dramatic cuts in government spending.

Over the CBO's 10-year forecast window, with the partial expiration of the Bush-era tax cuts, there is no insurmountable budget problem.[4] There is no fiscal emergency over this time horizon.

Our most important budget problems come *after* the ten-year horizon, because Medicare spending accelerates due to an aging population and increasing health care costs. The real issue here is containing healthcare costs – i.e., schemes that cut Medicare in such a way as to shift healthcare costs onto families do not offer an appealing solution, particularly as this would likely raise healthcare spending as a percent of GDP.[5]

We should aim to find a way to limit healthcare costs as soon as possible – every year of high healthcare cost inflation makes the problem worse. Our competitors are controlling healthcare costs much more effectively than we are; with the set of advanced countries, the US stands out as having the worst (highest) projections for rising healthcare costs through 2030 or 2050.[6]

The United States is in the midst of a significant demographic transition, in the sense that our population is ageing. We need to invest in education and ensure access to affordable healthcare to everyone if we are to increase productivity as the proportion of older Americans increases. Ultimately, higher productivity is necessary – although not sufficient – to ensure that older, retired workers can receive a sustainable level of reasonable benefits (including pensions and healthcare).

In this context and over the coming decades, the United States needs to make a longer-term fiscal adjustment. An important part of that should include additional tax revenues.[7] The Bush-era tax cuts reduced revenue to an excessive degree, given the ageing of society. We are still struggling to recover from that flawed way of thinking about our public finances.

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[3] Comparative cross-country estimates are provided in Jonathan D. Ostry, Atish R. Ghosh, Jun I. Kim, Mahvash S. Quereshi, "Fiscal Space," IMF Staff Position Note, September 1, 2010, SPN/10/11.

[4] See James Kwak, "The Weirdness of 10-Year Deficit Reduction," http://baselinescenario.com/2011/07/21/the-weirdness-of-10-year-deficit-reduction/.

[5] For more detail, see the CBO assessment of the budget proposal put forward by Congressman Paul Ryan: http://cbo.gov/sites/default/files/cbofiles/ftpdocs/121xx/doc12128/04-05-ryan_letter.pdf.

[6] See the IMF's Fiscal Monitor (October 2012), Statistical Table 12a, columns 3 and 4.

[7] For more details on the viable options, see *White House Burning*, particularly Chapter 7. Reducing tax expenditures is part of the sensible route to follow. These reductions can be phased in gradually.

It is striking the extent to which income inequality has increased dramatically since the last tax reform in 1986.[8] According to the latest available data, from 1993 to 2011, average real income for the bottom 99 percent of the population (by income) rose by 5.8 percent, while the top 1% experienced real income growth of 57.5%. The top 1 percent captured 62 percent of all income growth over this period.[9]

The returns to higher education have greatly increased in recent decades and, on average, there are not good income prospects for anyone with only a high school education (or less). If anything, the tax system should lean towards becoming more progressive – and investing the proceeds in public goods that are not sufficiently provided by the private sector, like early childhood education and the kind of preventive healthcare that helps prevent disruption to education (e.g., due to childhood asthma).

At the same time, we must not lose sight of the very large fiscal risks posed by the nature and structure of our financial system. Our worsening budget picture since 2000 is due to a combination of factors – including large tax cuts, two foreign wars, and the introduction of Medicare Part D. The recent increase in government spending as a percent of GDP is due almost entirely to the way the financial sector imploded and damaged the rest of the private sector in 2007-08.[10]

To see the fiscal impact of the last finance-induced recession, look at changes in the CBO's baseline projections over time. In January 2008, the CBO projected that total government debt in private hands—the best measure of what the government owes—would fall to $5.1 trillion by 2018 (23% of GDP). As of January 2010, the CBO projected that over the next eight years debt will rise to $13.7 trillion (over 65% of GDP)—a difference of $8.6 trillion.

Most of this fiscal impact is not due to the Troubled Assets Relief Program – and definitely not due to the part of that program which injected capital into failing banks. Of the change in CBO baseline, 57% is due to decreased tax revenues resulting from the financial crisis and recession; 17% is due to increases in discretionary spending, some of it the stimulus package necessitated by the financial crisis (and because the "automatic stabilizers" in the United States are relatively weak); and another 14% is due to increased interest payments on the debt – because we now have more debt.[11]

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[8] For more details and discussion of what accounts for the increase in inequality, see David Autor and Daron Acemoglu, "Skills, Tasks and Technologies: Implications for Employment and Earnings," http://econ-www.mit.edu/files/5571.

[9] This is from data on Emmanuel Saez's website, http://elsa.berkeley.edu/~saez/, downloaded on March 12, 2013. See the first item under "Income and Wealth Inequality"; the link to his spreadsheet is called "(Tables and Figures **Updated to 2011** in Excel format, January 2013)".

[10] Over the past decade, foreign wars also contributed to increased government spending. But the negative fiscal effect of the financial crisis was much larger than the cost of the Iraq and Afghanistan wars combined.

[11] See also the May 2010 edition of the IMF's cross-country fiscal monitor for comparable data from other industrialized countries, http://www.imf.org/external/pubs/ft/fm/2010/fm1001.pdf. The box on debt dynamics shows that mostly these are due to the recession; fiscal stimulus only accounts for 1/10th of the increase in debt in advanced G20 countries. Table 4 in that report compares support by the government for the financial sector across leading countries; the US provided more capital injection (as a percent of GDP) but lower guarantees relative to Europe.

We should be attempting to strengthen the safeguards in the Dodd-Frank financial reform legislation. Repealing or rolling back that legislation poses a major fiscal risk.[12] The fact that this is not currently scored by the Congressional Budget Office does not reduce this risk or make it any smaller.

In effect, a financial system with dangerously low capital levels – hence prone to major collapses – creates a nontransparent contingent liability for the federal budget in the United States.[13] This can only lead to further instability, deep recessions, and damage to our fiscal balance sheet, in a version of what senior officials at the Bank of England refer to as a "doom loop".

The remainder of this testimony reviews in more detail: why spending cuts – either from a government shutdown or from some other form of immediate austerity – will be contractionary in the current US context; and how to think about our debt levels in a cross-country perspective.

C. Spending Cuts Would Be Contractionary

Immediate spending cuts would, by themselves, likely slow the economy. The IMF's comprehensive recent review of cross-country evidence concludes: "A budget cut equal to 1 percent of GDP typically reduces domestic demand by about 1 percent and raises the unemployment rate by 0.3 percentage point."[14]

The contractionary effects of spending cuts can sometimes be offset by other changes in economic policy or conditions, but these are unlikely to apply in the United States today

If there is high perceived sovereign default risk, fiscal contraction can potentially lower long-term interest rates. But the US is currently perceived as one of the lowest risk countries in the world – hence the widespread use of the US dollar as a reserve asset. To the extent there is pressure on long-term interest rates in the US today due to fiscal concerns, these are mostly about the longer-term issues involving healthcare spending; if this spending were to be credibly constrained (e.g., in plausible projections for 2030 or 2050), long rates should fall. In contrast, cutting discretionary spending would have little impact on the market assessment of our longer-term fiscal stability.

It is also highly unlikely that short-term spending cuts would directly boost confidence among households or firms in the current US situation, particularly with employment still around 3 percent below its pre-crisis level. The US still has a significant "output gap" between actual and potential GDP, so unemployment is significantly above the achievable rate. Fiscal contractions rarely inspire confidence in such a situation.

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[12] See Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and The Next Financial Meltdown*, Pantheon, 2010.

[13] See Anat Admati, Peter DeMarzo, Martin Hellwig, and Paul Pfleiderer, "Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is *Not* Expensive," Stanford University, March 2011 (revised), https://gsbapps.stanford.edu/researchpapers/library/RP2065R1&86.pdf. See also Anat Admati and Martin Hellwig, *The Banker's New Clothes: What's Wrong with Banking and What to Do about it*, Princeton University Press, 2013, forthcoming.

[14] *World Economic Outlook*, October 2010, Chapter 3, "Will It Hurt? Macroeconomic Effects of Fiscal Consolidation," p.113. This study has important methodological advantages, in particular because it focuses on policy intentions and attempts to implement spending cuts and revenue increases.

If monetary policy becomes more expansionary while fiscal policy contracts, this can offset to some degree the negative short-run effects of spending cuts on the economy. But in the US today, short-term interest rates are as low as they can be and the Federal Reserve has already engaged in a substantial amount of "quantitative easing" to bring down interest rates on longer-term debt. It is unclear that much more monetary policy expansion would be advisable or possible in the view of the Fed, even if unemployment increases again – for example because fiscal contraction involves laying off government workers.

Tighter fiscal policy and easier monetary policy can, in small open economies with flexible exchange rates, push down (depreciate) the relative value of the currency – thus increasing exports and making it easier for domestic producers to compete against imports. But this is unlikely to happen in the United States, in part because other industrialized countries are also undertaking fiscal policy contraction. Also, the preeminent reserve currency status of the dollar means that it rises and falls in response to world events outside our control – and at present political and economic instabilities elsewhere seem likely to keep the dollar relatively strong.

The available evidence, including international experience, suggests it is very unlikely that the United States could experience an "expansionary fiscal contraction" as a result of short-term cuts in discretionary federal government spending. Recent experience with austerity in the United Kingdom should also not inspire to head rapidly in the same direction.

D. Fiscal Crises in Comparative Perspective

The advisable debt limit, relative to GDP, for the United States is subject to considerable debate and is not knowable with a high degree of precision. There is no precise debt-to-GDP level at which a crisis is triggered, but with net debt relative to GDP in or above the range of 90-100 percent, a country becomes much more vulnerable to external shocks – particularly if it is relying on foreign investors to buy a substantial part of its debt.

If any shock throws the economy into recession, fiscal policy in most industrialized countries will to some degree automatically counteract the effect – as spending increases (on unemployment benefits and other forms of social support) and taxation declines (as GDP falls). Such automatic stabilizers are generally helpful as they prevent the recession from becoming more serious – or even some form of prolonged collapse, which was the pre-1945 experience of many countries.

It is important not to oversimply fiscal concerns into precise cut-offs for "dangerous" debt levels. Recent European experience provides ample illustration that countries can run into trouble refinancing their debts at a wide range of debt-to-GDP values.

Greece ran into trouble in 2010 with gross debt relative to GDP of 144.5 percent; its debt levels in 2006 and 2007 were around 107 percent.[15] This is a classic case of too much debt by any measure – although the full extent of the debt and underlying deficits were not completely clear until market perceptions shifted against Greece. In addition, an important part of the problems in

[15] These data are from the latest available Fiscal Monitor, published by the IMF in October 2012 (http://www.imf.org/external/pubs/ft/fm/2012/02/pdf/fm1202.pdf); see Statistical Table 4. An updated version should appear in April 2013. International comparisons of fiscal accounts are difficult; we recommend using the gross general government debt numbers from the IMF's Fiscal Monitor.

Greece is structural – both in terms of how the eurozone functions as a monetary area, and in terms of the longer-run failure of productivity to converge towards levels in northern, higher income European countries.

Portugal faced a fiscal crisis with gross debt at 107.8 percent of GDP in 2011, but its gross debt was only 68.3 percent in 2007. The issue for Portugal is low achieved and expected growth relative to fiscal deficits – the markets have become unwilling to support debt that continues to increase as a percent of GDP.

Ireland, another eurozone country that currently has an IMF program, is a different kind of fiscal disaster. In this case, the on-balance sheet government debt was low (25 percent of GDP in 2007 for gross debt) but there was a big build up in off-balance sheet obligations – in the form of implicit support available to a banking system that was taking on large risks. Bailing out the banks in fall 2008 and supporting the economy during severe recession has pushed up gross debt to 106.5 percent of GDP in 2011 and debt levels will reach nearly 120 percent (in official estimates) before stabilizing.

In the UK, gross debt was 43 percent of GDP in 2006 (low relative to other industrialized countries at that time). Gross general government debt reached 75 percent of GDP in 2010, when the new Conservative government decided to adopt relatively austere budget policies. However, growth since that time has been lackluster and debt continues on an upward path. In the latest official projections, it will peak at 96.6 percent of GDP in 2015. Given that Britain does not belong to the eurozone and still has its own central bank, the wisdom of its current fiscal policy stance has increasingly been called into question.

Compared with other industrialized countries, Japan stands out as an extreme. Government debt-relative to GDP is expected to reach 245 percent in 2013 (on a gross basis) and rise to 248.8 percent in 2016. On a net basis – taking out government debt held by other parts of the public sector – the equivalent figures are 144.7 percent in 2013 and 155.6 percent for 2016. But nearly 95 percent of Japanese government debt is held by residents – and, at least for the time being, Japanese household and business savings remain high.

Countries with greater reliance on foreign savers, such as the US (where nonresidents held 30.2 percent of general government debt and 47.9 percent of marketable central government debt in 2012) and the UK (nonresidents held 31.1 percent of general government debt in 2012) need to be much more careful. Within the eurozone, as a result of greater financial integration combined with the mispricing of risk, foreigners typically hold 40-90 percent of all outstanding government debt (mostly held by other eurozone financial institutions).

The increase in debt relative to GDP in industrialized countries was from 77.2 percent in 2006 to 110.7 percent in 2012 (this is general government gross debt as a percent of GDP, calculated by the IMF as an unweighted average across countries). Most of this increase was due to automatic stabilizers, i.e., the increase in spending and fall in taxation that occurs whenever a country goes into recession.

Seen in that context, the increase in the US general government gross debt – from 66.6 percent of GDP in 2006 to 98.6 percent at the end of 2010 and 107.2 percent at the end of 2012 – was very much in line with experience in other countries.[16]

In terms of net general government debt held by the private sector, at the end of 2012, the US was around 83.8 percent of GDP – up from 48.2 in 2007. This is not yet at a dangerous level but the future projections are not encouraging – this number will rise to 89.6 percent in 2016 and 89.4 percent in 2017, according to the IMF. And in the Congressional Budget Office's longer-term projections, the future costs of healthcare cause a rise in debt to Japanese levels or beyond by 2030 or 2050.

The role of the US dollar as the world's preeminent reserve currency means there is a strong demand for our government securities in the foreseeable future. In 1948 and in 1968, world holdings of US dollar assets in the form of reserves were worth about 2 percent of GDP. Now world reserve holdings of dollar assets are worth at least 15 percent of GDP – and some would put this as high as 30 percent of GDP.

But it is not clear how far this will carry us – particularly as alternative reserve assets typically develop in a diverse world economy with competing national interests. It would be wise to undertake medium-term fiscal consolidation, i.e., over the next two decades. Rising healthcare costs, a weak tax base, and deteriorating public goods could well undermine our long-term potential growth.

In addition, the United States continues to face very large potential fiscal liabilities in the form of implicit support available to the financial sector, both directly – if "too big to fail" global banks get into trouble – and indirectly, in the form of automatic stabilizers that will always kick in when the economy declines sharply due to a banking crisis.

If a financial crisis due to the mispricing of risk causes a fiscal crisis, including immediate spending cuts and tax increases, this has major distributional consequences. The financial sector executives and traders who do well during a financial boom are highly paid; typically this is on a return-on-equity basis without appropriate adjustment for risk, so they take on too much debt. When the downside risks materialize, the costs of the crisis are borne by those who lose jobs and suffer other collateral damage.

If sharp spending cuts follow that reduce essential public services (e.g., government-funded education), this effectively transfers the costs of dangerous compensation schemes for the financial elite onto the middle class and relatively poor people.

There is nothing pro-market or pro-private sector about an inefficient redistribution scheme that allows a few people to become richer due to implicit government subsidies for "too big to fail" global financial institutions. Such firms are likely to damage themselves with some regularity – their executives have little incentive to be sufficiently cautious. If the consequent crises undermine public goods, such as access to effective education and quality healthcare, this is likely to permanently lower growth rates through undermining the human capital of the US workforce. Unfortunately, this is the trajectory on which we currently find ourselves.

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[16] These gross and net debt numbers are taken from the IMF's Fiscal Monitor, October 2012, Statistical Table 4. The 2012 data are a forecast.

OPINION: WINDOWS OF OPPORTUNITY CLOSING

(By Judd Gregg)

Two events are starting to close the windows of opportunity for this president to govern and for this Congress to contribute to governance.

The first became clear with the release of the minutes from the most recent meeting of the Fed. The days of expansive monetary policy and low interest rates are numbered.

It is obvious that, even among some members of the Fed's board, there is a growing restiveness about the policy of pumping near-limitless amounts of new dollars into the economy in the name of pushing full employment.

Yes, seeking full employment had always been one of the Federal Reserve's two core responsibilities. But the other one—the imperative to protect the value of the currency—has historically and appropriately taken precedence.

No one can look at the Fed's actions over the last few years and not conclude that the risk created by the constant and massive printing of money is real. Its potential to destabilize the dollar is significant.

This reality is beginning to cause the Fed membership, if not its leadership, to question whether staying the course of this extraordinary balance sheet expansion in pursuit of full employment is a good trade-off. It is inevitable that the Fed is going to have to take action to contract this expansion. Interest rates will rise. The adjustment will probably come sooner rather than later. The implications for the president, the Congress and federal fiscal policy are dramatic.

The Fed has been busily laying down a thick smoke screen that has allowed the president and the Congress to obfuscate the real cost of the incredible deficits and resulting debt that they have been running up over the last four years.

This cover is going to be pulled away as the Fed adjusts its policies. It will lead to a rather stark awakening. The unconscionable and profligate fiscal policies will be called to account for their true costs with a massive spike in the cost of federal interest payments.

If interest costs for the federal government simply return to their historic levels, it will add $400 or $500 billion of new expenses to the annual federal balance sheet. This will overwhelm any tax increase even this President can contemplate and any spending cuts that even the most ardent House Republican could pursue. It will mean billions and billions of dollars of unanticipated obligations.

If the federal government had a budget, which due to the Senate Democratic leadership it does not, it would blow a hole the size of Alaska in it.

All this for interest payments that do virtually nothing to help deliver a better-governed nation or a stronger economy. It is money thrown out the window. It will compound dramatically the difficulties involved in addressing our deficits and long term insolvency issue.

There is now a window of opportunity to correct the county's debt problem amid this artificial environment of exceptionally low interest rates created by the Fed. But the window is closing and it will not reopen.

The failure to get our fiscal situation in order during this unique period will go down as a major act of misfeasance by the President and the Congress. Neither history nor our children will view their actions kindly.

The second event that is going to limit the ability to govern by those charged with governing is the return to the election cycle. Some would say in observing the President's performance that he has never stopped electioneering.

But the fact remains that there is a period—albeit one which is fast moving toward its close—when, in theory at least, the two sides should be able to mute the politics and come together to govern. By the end of the summer, this window will also close. The chance will most l ikely be lost.

Both sides have an obligation to take at least one more serious run at getting something done to right the unsustainable course of our federal fiscal ship.

If first lady Michelle Obama allows her husband to play golf with Tiger Woods, it should not be too much of a reach to tell her husband to go play golf with the Speaker.

Tell them to hit the restart button. Tell them to do something good together for the county and our kids. Just the two of them in a golf cart for four hours working out America's, and for that matter the world's, problems. How refreshing that would be.

Judd Gregg is a former governor and three-term senator from New Hampshire who served as chairman and ranking member of the Senate Budget Committee and as ranking member of the Senate Appropriations subcommittee on Foreign Operations. He also is an international adviser to Goldman Sachs.

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