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Chairman Bowles, Chairman Simpson, members of the Commission - thank you for all the work you are doing on this important challenge of reforming the nation's budget to take us off of the unsustainable fiscal path. It is a difficult and at times I am sure, thankless, job. The problem with fiscal responsibility is that it is much less fun than fiscal irresponsibility. But if we don't make changes to our fiscal future, we—and future generations—will pay the price through a weaker economy, a lower standard of living, less growth potential, a less flexible budget, and a loss of leadership in the world. So good luck!

I am the president of the bipartisan Committee for a Responsible Federal Budget and the director of the Fiscal Policy Program at the New America Foundation. I am also part of the Peterson-Pew Commission on Budget Reform. Today, I offer a few thoughts and some specifics on how to get our staggering debt problem under control.

To summarize, the main points I will present are:

1. The Commission needs both a medium- and a long-term fiscal goal.
2. It's time to get specific.
3. Focus on policies that are conducive to growth.
4. Process reforms can be used to both help force changes and enforce a reform plan.

1. The Commission needs both a medium- and a long-term fiscal goal.
Due to a number of factors, what used to be a long-term budget problem fueled by growing health care costs and an aging population, is now at our doorstep.[1] As a result, we have a medium-term budget challenge, as demonstrated by the fact that the public debt is projected to grow from roughly 60% of GDP to 90% over the next ten years. But we also still have the longer-term budget challenge. Both spending and revenues are climbing well beyond historical levels. However, spending is growing much faster. The expanding differential will cause a dangerous debt spiral, leaving interest payments highly vulnerable to rate increases and squeezing out other important areas of the budget.

[1] Factors include running deficits during the period of growth leading up to the recession, the revenue losses and spending increases that resulted directly from the recession, and the costs of the policies that were implemented to deal with the recession.

The commission will have to come up with proposals to deal with both of these challenges. Getting control of the medium-term budget situation is critical for reassuring credit markets that the U.S. will continue to be a safe place in which to invest. Sovereign debt jitters can easily spread across the Atlantic and hit American markets at any point if we do not put in place a credible medium-term fiscal consolidation plan that will reduce our debt to more reasonable levels. As the International Monetary Fund has pointed out, this cannot just include stabilizing the debt at post-crisis levels, but rather, must involve bringing it down to pre-crisis levels.

The Peterson-Pew Commission on Budget Reform has recommended that we stabilize the debt at 60% of GDP—a well-recognized international standard, which is important given the emphasis we must put on reassuring global credit markets—by 2018. We believe this is the most aggressive, yet simultaneously politically viable, goal. We also strongly advocate further reducing the debt level lower – closer to the historical 40% average – thereafter.

There are other possible fiscal targets that have been proposed including the one set out for this commission. More important than the exact year or precise debt target is that we put in place a plan quickly, so as to reassure credit markets and keep interest rates low, subsequently supporting economic recovery and future economic growth. A reasonable plan would span the next 5 to 10 years and would make a credible commitment to reforms as quickly as possible, phasing them in gradually so as to avoid derailing the economic recovery.

But this will not be enough. In order to reassure credit markets and help strengthen the economy, a longer-term plan will also have to be put in place to control projected federal spending, close the gap between spending and revenues, and alleviate the current uncertainty that confuses citizens and creditors about the direction of future fiscal policy. Stabilizing the debt so that it will not grow faster than the economy beyond the medium-term budget window—as Peterson-Pew, and more recently the G20, have recommended—is the best way to achieve longer-term budget stability.

It is worth noting that in all likelihood it will require different policies to achieve both the medium- and longer-term goals. In the medium term, it is likely that more savings will come from discretionary programs, including both defense, domestic discretionary, and revenue changes (including reforming tax expenditure programs and modernizing our tax system). Many of these changes can be made more quickly than reforms to the real problem areas. In the longer-term, the bulk of reforms will have to come from the drivers of spending growth—entitlement programs—primarily spending on Medicare, Medicaid, and Social Security since these are the programs causing the greatest pressure and budget. Simply put, without changes to these areas of the budget, the debt cannot be stabilized over the long-term at a reasonable level of GDP.

2. It's time to get specific.

There has been a discouraging political timidity about naming specific policy changes to lower and stabilize the debt. As a result, the country may not be fully prepared for the types of changes that need to be considered. It is therefore useful to propose as many productive ideas about what we should do (rather than what we should not do) so that we can proceed with a more realistic understanding of what is involved and consider the various trade-offs between different approaches.

Fig. 2: Plan to Stabilize the Debt at 60% of GDP

	<u>**Savings in 2018 ($Bil)**</u>
Defense	**$70**
• Reduce weapon systems, reduce troop levels, reform procurement policies, reform Tricare	
Discretionary	**$140**
• Eliminate outdated programs • Reduce domestic discretionary spending by 5%, short-term freeze, cap growth	
Social Security	**$60**
• Speed up/increase retirement age to 68 and index for longevity • Slow growth of benefits for middle and upper earners • Switch to superlative CPI • Update/reduce spousal benefits	
Heath Care	**$120**
• Reduce new insurance subsidies • Increase cost sharing/premiums for Medicare • Increase retirement age for Medicare • Reform malpractice policies • Reduce Medicaid funding to the states • Introduce a voucher option • Institute a cap on federal health spending to restrict growth to GDP + population + 1% starting next decade	
Other	**$60**
• Eliminate agriculture subsidies • Reduce other mandatory spending • Freeze government salaries for two years, reduce workforce by 5%, reform contracting process	
Revenues	**$300**
• Tax expenditure reform: Gradually eliminate the health care exclusions; phase down the home mortgage deduction from $1 million to $500k; eliminate state and local tax deduction; reduce corporate subsidies; other consolidations/eliminations; cap total amount of tax breaks as a share of income • Implement a carbon tax • Only extend the expiring 2001/2003 tax cuts temporarily (2 years at most) with the commitment to only extend permanently once a debt reduction package has been put in place	
Sweeteners	**- 100 bil**
• Corporate income tax rate cut • Bump up in spending on some of the most productive public investments (education, R&D, infrastructure)	

Note: These numbers have not been officially scored and reflect only very rough estimates.

Fig. 2: MAJOR METRICS UNDER BASELINE AND PLAN

	2018 Baseline	2018 Plan	2030 Baseline	2030 Plan
Spending	24%	22%	29%	23%
Revenues	19.5%	21%	19%	21%
Deficit	5%	1%	10%	2%
Debt	84%	60%	130%	45%

Note: These numbers have not been officially scored and reflect only very rough estimates.

In that vein, I offer a specific proposal to meet the medium-term goal of bringing the debt back down to 60% of GDP and the longer-term goal of stabilizing it at a lower level. This plan does not necessarily reflect the views of the Committee for Responsible Federal Budget, whose diverse board is made up of many of the nation's preeminent budget leaders, but rather reflects my own proposal.

There are, of course, many ways to achieve the goal of stabilizing the debt at a reasonable level in a reasonable time frame. The plan I present here is indented to achieve the targets through a balanced set of proposals, in a way that protects the most vulnerable, keeps principles and sound policy objectives in mind, damages the economy as little as possible.

All areas of the budget are affected. Defense is a logical starting point. There are large savings to be found because during wartime, the defense budget tends to get ramped up even in areas unrelated to the war. It is also an opportunity for a coalition of strange bedfellows from the right and the left to agree on reductions. We will also have to engage in a large rethinking of our role in the world.

Domestic discretionary cuts and freezes should be used to push the decision making about which programs have outlived their mission or are the lowest performing back down to the agencies and experts. Capping growth should be used to keep budgetary pressure on over the long-term.

Social Security should be updated to reflect growing life expectancies and the fiscal reality that we cannot afford to provide such generous benefits for those who do not need them, especially when other critical priorities remain unfunded. We should have made changes to this program years - if not decades - ago, given that we knew about the demographic challenges it faces. As a result of our ongoing delay, we will now have to phase in changes more quickly than we otherwise would have.

More savings in health care still need to be found. The subsidies in the new health care package are quite generous given our fiscal realities, and can be scaled back. More changes will have to be made to Medicare and Medicaid including reducing the role of federal financing in both programs. Increasing the retirement age that will affect Social Security should apply to Medicare as well. Over time, it would be advisable to fundamentally restructure Medicare to provide a voucher program, which would introduce more cost consciousness and cost controls. Given the progress in creating exchanges in the recent health reforms, this is now more of a possibility. Broad spending controls will have to be introduced to federal health care spending, including a cap on spending growth and triggers to ensure that projected health care savings are realized.

Taxes will have to go up. This should start with broadening the tax base by reducing, eliminating, and consolidating many of the tax credits, deductions, exemptions, and exclusions that permeate the base. The supposed “third rails” of the tax base including the exclusion for employer-provided healthcare and the home mortgage interest deduction should be at the top of the list for reform.

Additionally, to fill the gap, new revenues will likely have to be introduced. My preference would be for a broad-based carbon tax that would have benefits spilling over into the areas of energy dependence and environmental protection, as well as raise revenues. We should also consider raising more from an energy tax than is necessary and using part of the revenues to replace less desirable taxes.

Pledges not to raise taxes or not to raise taxes for families making less than $250,000 per year are unrealistic and should not be made by anyone unwilling to show specifically how they would achieve the goal of getting the budget under control without additional revenues. In fact, taking anything off the table without specifying what one would do to achieve a reasonable budget goal is counter-productive, and given the gravity and magnitude of the fiscal challenges we face, it jeopardizes the economic wellbeing of citizens who are counting on our leaders to do the right thing and act before we are forced to do so by some type of fiscal crisis.

Sweeteners are always helpful in making a budget deal more palatable, but with multiple rounds of tax cuts and entitlement expansions in the past years, there is little room left for sweetening the budget pot. I suggest the two that I think are the most important to update our policy priorities and to help with economic growth: cutting corporate income tax rates and investing more in certain public priorities.

One of the toughest points of contention is how much of the budgetary changes to make on the spending side of the budget versus the tax side. Budget imbalances are driven by spending growth. That said, it is virtually impossible to bring spending down to a sustainable levels without increasing revenues, given political realities and politicians’ unwillingness to restructure certain programs.

Accordingly, I would suggest a goal of closing the medium-term gap through at least 50% spending cuts, and the long-term gap through at least 75% spending cuts. It is worth noting that the most successful fiscal turnarounds in other countries have emphasized spending cuts over tax increases.

3. Focus on policies that are conducive to growth.
The act of getting the debt back down to a sustainable level should not be seen as merely an exercise in getting the numbers to add up. We have to be guided by thoughtful consideration of the most important national priorities; which government tax and spending programs are working the best, which are working the worst; and which national values our budget should reflect.

We also have to understand that realistically, while economic growth will not come anywhere close to fixing our fiscal problems, it sure will make climbing out of this fiscal hole a lot easier. Therefore, as we pick and choose what to spend more on, what to spend less on, and how to raise the needed revenues, the effects on economic growth should be considered at every step of the way.

For years, our budget has emphasized consumption programs over investment and has left us with a number of underfunded investment areas. My preference would be to turn these priorities on their head, and to put a much greater share of the federal budget's resources into productive investments and long-term priorities, while reducing the tremendous subsidies we provide to enable higher levels of consumption. The emphasis we place on supporting voters over 65 relative to children under 18 seems, to me, a misplaced priority. We also should not be shortchanging public investments in areas such as labor force development, infrastructure, education, and basic R&D, that will facilitate future growth. But to be clear, we have run up our debt to such levels that arguments that these investments will pay for themselves or should be debt-financed will lead to an undermining of any potential economic benefits, and instead we should cut less productive spending to pay for any new investments.

Fundamental tax form is also critically important to economic growth. Our current tax system is so preposterously bad that it leaves plenty of opportunities for improvement that will be conducive to growth. Broadening the base and lowering rates, shifting from an income to a consumption base, and taxing more of the things we want less of, are all opportunities to restructure our tax code in a way that also improves growth. While indeed, revenues will have to go up, plans that are too tax heavy will have the effect of dampening growth, which will lower the standard of living and stand in the way of the very fiscal improvements we are striving for.

4. Process reforms can be used to both help force changes and enforce a reform plan.
Finally, changes to the budget process can help lead to better fiscal outcomes. Currently, we have a budget process that does not guide priority setting or help to keep the budget on track. Outdated budget concepts and nontransparent accounting rules stand in the way of presenting a clear picture of what our government does and doesn't do, and the fiscal effects of the choices it is making.

A sensible approach would be to incorporate specific fiscal targets into the budget process. This is something the Peterson-Pew Commission emphasized in its first report, *Red Ink Rising* (www.budgetreform.org). The Peterson-Pew Commission is now developing in more detail a second volume that will be released this fall.

In our first report we suggested a six step process:

Step 1: Commit immediately to stabilize the debt at 60 percent of GDP by 2018;
Step 2: Develop a specific and credible debt stabilization package;
Step 3: Begin to phase in policy changes in 2012;
Step 4: Review progress annually and implement an enforcement regime to stay on track;
Step 5: Stabilize the debt by 2018; and
Step 6: Continue to reduce the debt as a share of the economy over the longer term.

In our upcoming report, we will focus on the importance of both medium- and long-term fiscal targets and the use of budget triggers and other mechanisms to help keep multiyear budget plans on track. Another important element of our suggested budget regime will be improved transparency throughout the budget process and ways to shift the focus in budgeting away from the short-term to take a more comprehensive view of the budget choices we are making.

Thank you for the opportunity to appear here today. I will close by saying, the reason for making changes to our budget to improve our fiscal standing is not for the sake of fiscal austerity but as a path to improved prosperity. The U.S. needs to deal with our fiscal challenges. We also need to update our outdated tax and social insurance programs, deal with the competitive realities of a global marketplace, and reorient our budget more towards savings, investment, innovation, and competitiveness. The fiscal realities we face give us the opportunity to thoughtfully overhaul our budget in a way that will make it more suited for the challenges and opportunities of the new century.