TESTIMONY OF WILL MARSHALL

PRESIDENT OF THE PROGRESSIVE POLICY INSTITUTE

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Chairman Bowles, Chairman Simpson, and Members of the Commission, I appreciate the opportunity to appear before you to discuss ways to put America on a fiscally sustainable course.

Once unemployment rates start to fall, U.S. policy makers must be prepared to pivot sharply from fiscal stimulus to fiscal restraint. Otherwise, a large and growing federal debt will deplete our capital stock and thereby limit future economic growth. It will divert resources from productive investment to interest payments on the debt, half of which is already held by foreign lenders. And it will shake investor confidence, here and abroad, in the fundamental soundness of the U.S. economy, eventually driving interest rates up and the dollar down.

Despite these dire and entirely foreseeable consequences, too many federal policy makers remain in denial about the need for fiscal discipline. You have taken on what many consider a Mission Impossible: forging a bipartisan consensus on how to defuse the nation's debt crisis. That's put you in the crosshairs of extreme partisans of the left and right, who imagine this problem can be solved strictly at the other side's expense. By refusing either to cut spending or raise taxes, the two have joined in a tacit conspiracy to bankrupt the country.

Common to both is the assumption that you can have fiscal responsibility, or you can have progressive government, but you can't have both. We at the Progressive Policy Institute have always rejected this false choice. We believe that a progressive government can and must live within its means, and that if it instead chases the illusion of borrowed prosperity, it's not really progressive.

To paraphrase Franklin Roosevelt, Americans know instinctively that borrowing routinely to consume more than you produce is both bad economics and bad morals. I don't think it's an accident that, as public worries about deficits have been mounting, public trust in government has been plummeting.

So there's a lot riding on your ability to forge consensus behind a bold and balanced plan to restore fiscal responsibility. Let me offer some thoughts on what that plan should include from the perspective of a "progressive fiscal hawk."

We've dug a pretty deep hole, so it's not realistic to talk about balanced budgets anytime soon. What's needed instead is an ambitious but attainable fiscal target to shoot for. The National

Research Council and the National Academy of Public Administration in their indispensible report, *Choosing the Nation's Fiscal Future*, set a reasonable target: stabilizing the national debt at 60 percent of GDP within the next decade, and working to reduce it afterwards. It may also make sense to set targets for annual budget deficits, but only in tandem with a national debt target. We can tolerate fluctuations and spikes in short-term deficits; it's the inexorable rise in our long-term debt that poses the gravest threat to America's future growth and economic sovereignty.

Stabilizing the national debt at that level would preserve what Austan Goolsbee, in a PPI report, called America's "strategic fiscal reserve." In other words, it would leave room for deficit spending should the United States find itself facing another emergency like the credit freeze and recession of 2008-09, without pushing our debt-to-GDP ratio toward the danger zone of 100 percent or more.

It's worth quoting the *Choosing* report in full on this point:

> The committee judged that a debt of 60 percent of GDP reflects an appropriate balance and is an achievable target within a decade—and is therefore useful to guide policy choices that will ultimately be made by elected leaders. This is a different ratio than the committee would have likely proposed under different circumstances. Indeed, it will surely be seen by some as too high and by others as too low. But the committee believes it is the lowest ratio that is practical given the fiscal outlook. A higher debt burden would leave the nation less able to cope with unforeseeable but inevitable shocks—such as international crises or natural disasters—requiring a vigorous federal response. It would put the nation closer to a point from which no politically credible path to sustainability could be constructed. Moreover, stabilizing the debt at a higher ratio implies a higher deficit, a greater draw on the nation's saving or more foreign borrowing, which will have a negative impact on future living standards. On the other side, a lower ratio would imply even more painful changes in tax and spending policies.

A FAMILIAR MENU OF OPTIONS

Getting agreement on a target is half the battle, since it determines the magnitude of the tax and spending changes that must be made. Most budget and policy analysts work from a familiar menu of options, and assume that any politically feasible package will have to be split roughly 50-50 between tax hikes and spending cuts.

We believe the menu should include these actions:

- Cap discretionary spending. Alice Rivlin estimates that a hard freeze on discretionary spending would save over $1 trillion between 2012 and 2018.

- Trim future Social Security benefits. The big three—Medicare, Medicaid and Social Security—are driving the unsustainable growth of public spending. It's true that closing Social Security's funding gap is relatively easy compared to controlling the growth of health care costs. But that's an argument for repairing Social Security first.

The best way baby boomers like me can contribute to fixing Social Security is to work longer. PPI also has endorsed progressive indexing of Social Security benefits, which entails a shift from wage indexing to price indexing of benefits for well-off retirees who have other sources of retirement income. Under progressive indexing, benefits of high earners (over $90,000 per year in average career earnings) would grow with inflation, while those of middle earners would grow at a rate somewhere between inflation and the rise of wages. The bottom 30 percent, who are least likely to have other income sources, would continue to have their benefits indexed by wage growth. According to Robert Pozen, this would reduce the present value of the 75-year deficit of Social Security by somewhere between $2.6 trillion to $3.2 trillion, depending on how it's designed.

- Contain Medicare and Medicaid costs. This is hands-down the toughest fiscal challenge facing the nation. In addition to raising the age of eligibility, reducing Medicare's growth rate will require applying income-relating of Part B premiums to a broader swath of beneficiaries. We also need a stronger Medicare Commission empowered to example all aspects of Medicare, including its dominant fee-for-service design – not just prices and payments. Ultimately, the federal government will probably have to cap health care spending, either on a per capital or global basis. Therefore, I'd encourage the Commission to revisit two ideas: adopting vouchers or "premium support" for Medicare, and turning Medicaid into a block grant.

- Cut tax expenditures. Back in the mid-1990s, PPI developed a long list of tax expenditures – backdoor subsidies to individuals and businesses – that had outlived their original rationale. It's a testament to the immortality of federal programs that most of them are still on the books. The Joint Tax Committee lists tax expenditures costing more than $1.2 trillion in foregone revenue. We continue to believe a base-closing commission should be established to draw up a hit-list and present it to Congress for an up-or-down vote. This should be seen as part of a base-broadening exercise that would also allow for lowering tax rates, though of course tax reform also needs to raise additional revenues to reduce the government's need to borrow.

Now let me offer for your consideration three specific recommendations that might be less familiar:

First: Bring mandatory spending on budget.
Second: Let Bush tax cuts expire or extend them temporarily.
Third: Put defense spending on the table.

AN ENTITLEMENT BUDGET

The first recommendation was developed by the Brookings-Heritage Fiscal Seminar, of which I'm a member. The Seminar is a nonpartisan group of budget and policy experts from various Washington think tanks that includes three former CBO Directors: Alice Rivlin, Rudy Penner and Bob Reischauer.

The idea very simply is to take entitlement spending off auto-pilot, and establish a fixed, overall budget for the Medicare, Medicaid and Social Security.

These entitlement programs grow automatically each year, with no deliberation by Congress, no pressure to reconcile spending and revenues, no attempts to adjust them for demographic changes or generational equity, and no attempts to make trade-offs among competing public priorities.

The best solution, of course, would be for this Commission to propose, and Congress to accept, major structural reforms in the big three entitlements that allow them to continue to provide health and retirement security without running up massive deficits. Even so, bringing them on budget would provide greater transparency and allow Congress to mark progress toward solvency.

The plan works like this: Congress and the president enact explicit, long-term budgets for Medicare, Medicaid and Social Security. With this one step, entitlements would be forced to compete for budget dollars with other vital national priorities.

Either the trustees or the Congressional Budget Office would review the programs at regular intervals, possibly every five years, to determine whether they stay within their budget. Failure to do so would trigger automatic adjustments in benefits, premiums, provider payments or tax revenues.

Of course, Congress could override these adjustments – but it would have to take explicit action to jettison fiscal constraints. This is preferable to its current passivity in the face of automatic, formula-driven spending growth.

Finally, this proposal would end the ever-narrowing scope of Congressional decision-making, and fully restore lawmakers' constitutional power of the purse.

THE BUSH TAX CUTS

The major Bush tax cuts passed in 2001 and 2003 are set to expire at the end of this fiscal year. Last week House Majority Leader Steny Hoyer made headlines by wondering aloud about the wisdom of permanently extending any of the Bush tax cuts absent a serious plan for long-term deficit reduction. It's a good question.

Extending all the Bush cuts, as some Republicans insist, would cost at least $3 trillion over the next decade. All of that would be added to the national debt since GOP leaders have yet to embrace an offsetting list of spending cuts.

During the 2008 campaign, then-Senator Obama promised to extend the Bush cuts for the "middle class," defined as families earning less than $250,000 and individuals earning less than $200,000. According to the Joint Committee on Taxation, that would add $1.4 trillion to the nation's debt over the next decade.

Of course, the nation's fiscal outlook has deteriorated dramatically since the campaign. The cost of averting a financial and economic collapse last year could push this year's deficit to $1.7 trillion. The national debt has swollen from 40 percent in 2008 to 60 percent now and is on course to reach 90 percent of GDP by 2020.

Cutting taxes in wartime never made sense to me. The truth is, America really can't afford any of the Bush tax cuts right now. I know: it's an election year and no one wants to be accused of "raising taxes on the middle class." But if Congress ends the fiscal year with a huge, unpaid-for extension of tax cuts, right before this Commission is supposed to deliver the President a credible plan for debt reduction, it will send a confusing signal to investors anxious about our deteriorating fiscal picture, as well as other nations taking painful steps to get their fiscal houses in order.

A one-year extension, by contrast, would send a bracing signal of seriousness. And it would give this Commission a lot more room to devise a balanced package of spending and tax changes aimed at whittling down our debts.

A CONTRIBUTION FROM DEFENSE

Third, no program should be exempted from the new constraints of fiscal discipline, including defense.

PPI has always stood unequivocally for a strong defense. We have opposed routinely irresponsible calls by some in Congress for deep and arbitrary cuts in military spending. At the same time, we've criticized a wasteful and inefficient procurement system, the Pentagon's habitual reluctance to clarify roles and missions and make hard choices among competing priorities, and Congressional moves to buy more weapons than the military says it needs.

We've also argued that America's qualitatively superior, high-tech military and global reach grow out of a vibrant domestic economy – a theme that also runs through the administration's new national security strategy. Keeping our economy strong is thus a prime imperative for U.S. defense policy.

In the 1990s – the last time America got serious about fiscal responsibility – declining military spending after the Cold War contributed mightily to bringing the federal budget back into balance, and indeed, into surplus. Military spending was 5.5 percent of GDP when Bill Clinton was elected and fell to 3.6 percent by the time he left office.

With America embroiled in two wars and a global counterterrorism campaign, we're obviously not going to reap another such peace dividend soon. Last year, military spending went back up to 5.5 percent of GDP and may exceed 6 percent this year. Nonetheless, with U.S. troops scheduled to quit Iraq by the end of 2011, and possibly beginning to draw down in Afghanistan before that, it's not unreasonable to assume that *future* military budgets can be constrained in the interests of securing fiscal stability.

By one estimate, a "hard freeze" on military spending, meaning no inflation adjustment, would save over a $1 trillion between 2012 and 2018. The Pentagon could still shift resources into urgent areas of need, but it would have to make up the difference by cutting other programs. For purely illustrative purposes, here are several CBO options for cutting military spending:

- Reverse the "Grow the Army" initiative once U.S. troops leave Iraq, and let the Army shrink from 547,000 to 482,200. Obviously, changes on the ground in Iraq or Afghanistan would have to be taken into account. CBO says this change would save $90 billion over 10 years.

- Reduce F-35 Joint Strike Fighter buy for USAF and USN with possible supplemental UAV purchases to boost warfighting capability. This could save anywhere from $47 to $67 billion over 20 years.

- Raise military health care premiums and deductibles, for a savings of $6-8 billion annually.

Finally, PPI believes it is time to end the practice of supplemental budgeting of war and other defense spending. The supplemental budgets have become larded with provisions unrelated to war needs, including over $20 billion in "no compete" procurement contracts. By including all funding in the baseline budget, Congress would force trade-offs that give priority to wartime requirements.

Thank you.