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An important and daunting task

I would first like to thank the commission for the opportunity to appear today. The task you face is both important and daunting.

The task is important because the deficit levels projected for 2015 and beyond will, if nothing is done, eventually bring harm to our nation's economy and hamper the ability of our government to deliver important public services as interest payments take a greater and greater share of tax dollars. The task is daunting for a number of reasons.

The first is obvious: tax increases and program cuts are difficult to do in a democracy because neither are popular. Designing an approach that can garner sufficient support is a significant challenge, to put it modestly.

In addition to this political challenge, addressing the middle and longer-term fiscal situation is particularly daunting right now in this very fragile economy. It's imperative to bring the deficit down, but bringing it down too quickly would be a disaster. There is nothing in the commission's mandate to require rapid deficit reduction in the next year or two and there's a good reason for that: doing so would seriously cramp our economic recovery and would, in fact, make longer term deficit reduction less likely. It has become a cliché to say "we can't grow ourselves out of our deficit problem." It's true, of course, but it's also true that we're not going to "spending-cut our way out of the deficit problem" or "tax ourselves out of our deficit problem." Each of these components—revenue increases, spending cuts, and economic growth—will have to play a key role if we are to be successful. The consequences of moving towards a balanced budget without an assist from economic growth would be devastating for the country—a grim scenario that we may see in Greece. So getting the balance right between bringing deficits down, but not aborting our economic recovery, is also a challenge.

Finally, in the context of this commission—assigned the specific task of improving the nation's fiscal situation—it might be easy to forget or ignore the possibility that the cure to our middle- and long-run deficit could be worse than the disease. Yes, there are potentially important negative consequences to deficits. But there are also potentially important negative consequences to underinvesting in our children, to shortchanging our national infrastructure, and to counterproductive taxation. As a matter of arithmetic we can hit whatever deficit targets we want—but if we balance the budget in an irresponsible way we could end up doing net harm to our nation and its economy, balanced budget or not.

How we got here

In finding the solution it's important to remember where the current deficits come from. Just 10 years ago we were, of course, running surpluses not deficits. Tax increases, budget restraint, and a growing economy took us from large deficits at the beginning of the Clinton presidency to a surplus in 1998—a condition that lasted through 2001. Since then substantial tax cuts, unpaid-for wars and new programs, and the failure until this year to address the rising costs of health care spending, have lead to the structural deficit we have before us. Even after we get past the extraordinary fiscal costs of the recession—a large part of which have come from falling tax revenues—we will be faced with the fiscal impact of these policies.[1]

The first step to getting rid of our long-term deficit problem is to start addressing what got us here. As noted, getting the economy growing is key. And it is very important to allow at least some of the tax cuts of the 2000s to expire at the end of this year on schedule. The president's proposal to offer the middle class a tax cut while letting the tax cuts expire on those making more than $250,000 per-year is a reasonable compromise between addressing deficit reduction and what's realistic; it's also well tuned to the uncertain economic times. The other administration proposals on the revenue side—eliminating some tax expenditures related to the oil industry, putting in place multinational corporation tax reforms, the bank tax, and the limiting of the benefits to high-income people of itemized deductions are all important steps. Also important are the proposals to constrain spending, getting rid of programs that don't work, and improving government efficiency. Although we don't want to short change our national security, if we do not end the wars in Iraq and Afghanistan we are absolutely going to have to find a way to pay for them. It's a clear choice. And, of course, we've passed health reform but it's imperative that it be implemented aggressively to reduce budget deficits.

But even if these actions are taken, there is a structural deficit that will persist. Focusing on the year 2015 and the commission's specific target of hitting primary balance, the projected primary deficit in the president's budget blueprint, as calculated by the Congressional Budget Office, is 1.4 percent of GDP.

What should the commission offer?

The first thing to consider is what the commission should be striving for as a final product. One approach that I strongly discourage the commission from taking is to simply recommend caps on broad spending categories without specific proposals of how those targets are to be hit. This approach is tempting, particularly in the area of discretionary spending, but if that's all the commission does it will have contributed little. It's easy to just pick a number and say "we're not going to spend more than that." The hard part of dieting is not picking the target weight; the hard part is the discipline of exercise and cutting down the calories. But that's the part that matters. Cuts are going to be painful. Tax increases are going to hurt. The public has a right to know what the commission is proposing because it will actually affect them. As importantly, unless the commission explores the actual consequences of its decisions on actual programs, investments, and taxes, it is unlikely to get the balance right.

Nor should the commission be tied to arbitrary divisions of "discretionary spending," "mandatory spending," or taxes. Fundamentally, the exercise of deficit reduction is addressing what the priorities of government ought to be. Those priorities are not determined by some set of assumptions associated with, or, assignment of numbers to, broad, generic, categories of spending or taxation. Those priorities are set by defining a list of what the proper roles and goals of government are, determining what set of programs best serve those roles and goals, deciding how much of that set of programs is affordable and worth the cost to taxpayers, and then figuring out how to pay for them. Any other approach to the problem, wedded to categories of spending that are essentially valueless and disconnected from a determination of priorities, will, not surprisingly, produce a result that is valueless and disconnected from a determination of priorities.

The components of the deficit reduction discussion

It is important to recognize that different areas of the federal balance sheet offer different levels of potential deficit savings for different points in time in the future. Some of the largest programs in the budget are not the most likely candidates for significant savings in 2015, but probably offer more help in the long run. Other areas might not have much to contribute ten or fifteen years from now, but will be crucial for deficit reduction in 2015.

Social Security

Even though there is a long-term imbalance in Social Security, cutting Social Security spending to any significant degree in 2015 is unrealistic and would be unfair to current and soon-to-be beneficiaries. Even in the longer term, the Social Security program as a whole is not the most important cause of the problematic deficit forecasts. That isn't to say addressing the projected imbalances in Social Security isn't important—but doing so will only make a modest contribution to overall deficit reduction. At most, Social Security should be thought of as a potentially modest part of the solution.

Health care

The health care part of the budget is also unlikely to contribute substantially by 2015. Congress has just been through a painstaking process to address the long term health-care challenges of the country. The system has been redesigned—for the better—and is unlikely to be revisited before there is an opportunity to assess the fruits of that effort. Since it will take several years for the reform to be fully implemented, that time will not come before 2015, let alone by December when the commission's recommendations are due.

Nevertheless, the nation is about to enter a critical implementation stage of health care reform. The commission should encourage the administration to be aggressive in this implementation: with steps to test, evaluate, and adopt effective payment reform, and to promote partnership with the private sector to assure system-wide change in payment structures and incentives. How effective such measures are, and how we learn from our experiences with reform, will have much to say about our long-term fiscal future.

Other nondefense spending

Nondefense spending, including both its discretionary and mandatory elements, will certainly be on the table, but there is much within this area of the budget that would be shortsighted to cut substantially, including investments that are important to our economy (e.g. education, scientific research, technology investments), programs that are fundamental to our safety (e.g., the FAA, consumer product safety commission) and basic supports that are a moral obligation (e.g. veteran care, food stamps). There are certainly areas within this category that deserve close scrutiny, but it is important that this area of spending not become the focal point of deficit reduction, as it sometimes has in the past. This category of spending only accounts for 28 percent of the federal budget. Cutting too substantially here will move the cuts into the realm of programs that are too important to the country to be undermined.

Defense spending

Defense is an area where, we all hope, by 2015 there will be the possibility of substantial reductions as the wars in Afghanistan and Iraq come to a close. In fact, when President Obama announced a new U.S. strategy for Afghanistan in December 2009, he spoke of the need for a confined set of objectives that could be achieved in a specified time frame, citing in part the need to limit the mission to one that could be achieved at "reasonable cost." The president took some criticism for citing cost as a basis for constraining security objectives. Yet, it is evident that at some point more defense spending can make a country weaker—if "strength" is rightly understood to be about more than just short-term military power. A country that becomes economically weakened because it has shortchanged necessary domestic investments and carries excessive levels of debt will also eventually be a weaker country across the board.

An overall defense strategy that is fiscally unsustainable will fail every bit as much as a strategy that shortchanges the military.

Even with a built in assumption that the wars in Iraq and Afghanistan will be concluded before 2015, U.S. defense spending in that year is still projected to be at a higher level, adjusted for inflation, than in any year in the entire post World War II period prior to 2005. The United States spends about as much on defense as every other country in the world combined.

The commission should examine both procurement and the larger strategic question of whether our country must maintain its post-9/11 ground force strength as the wars in Iraq and Afghanistan come to a close, and whether the current military pay structure and health benefits are necessary and sustainable going forward.

The commission should also recommend a unified security budget that includes all our instruments of national security, military, and nonmilitary, as a way to ensure that our tax dollars are paying for what is most effective to ensure our national defense. Sometimes a dollar of foreign civilian assistance can advance our security more than a dollar of weaponry.

The bottom line is that without addressing defense spending it will be difficult to reverse the growth of unsustainable deficits. The commission needs to consider whether this level of investment in the Pentagon is the best way to keep our nation secure.

Government efficiency

I have said that tax cuts and spending cuts are painful and this is all very difficult. That's true. They are difficult because almost no one wants to see their taxes go up and every spending program has a purpose and a constituency. But it is also true that there are inefficiencies in government that can be rooted out. Of course, going after these inefficiencies is difficult too—many are deeply rooted in the bureaucracy and systems of government. But they must, nevertheless, be sought out and eliminated. Eliminating inefficiency is something that the entire body politic should be able to agree on. The administration has taken some excellent steps with the appointment of Chief Performance Officer Jeffrey Zients, achieving $19 billion in procurement savings, implementing the IT Dashboard that allows close public scrutiny of federal IT contracts, along with other measures.

Some of what needs to be done to make government more productive is, in fact, eliminating programs that aren't working. That will take a greater rigor on the part of both the executive and legislative branch. Strong recommendations by this commission regarding the need for thorough, on-going, program evaluation could be an important boost for this effort.

Second, managers in government agencies should be given the authority and incentives to make their programs operate effectively and efficiently. Government reform isn't a new idea, but the fiscal imperative means we must be open to far more dramatic steps to motivate and empower those best situated to drive change—public servants who are charged with and accountable for getting results. Third, a range of government practices in procurement, contracting, and technology should be reformed. The Obama administration already anticipates $40 billion in savings from reforms to the contracting process. Improvements to federal information technology systems could additionally reduce costs by another $16 billion a year.

In an era of scarcity, to have successful programs address our national needs requires that each dollar be spent efficiently and effectively—both to make our tax dollars go farther and to ensure that there is broad support for necessarily public solutions to public problems. It may seem pro-forma to talk of making government more efficient, but a passionate call by the commission, with a set of specific recommendations on steps to be taken to make government truly function better, could be the game changer that is needed to pull this issue out from obscurity, and separate it from the partisanship and ideological disputes that will have unavoidable prominence in most of what needs to be done to address the nation's fiscal challenges.

Tax expenditures

As the commission looks at the different categories of spending, it is also important that it examines spending that is administered through the tax code. Many policy areas, from energy to housing to technology research, are funded not just through direct spending, but also by delivering support in the form of reduced taxes. Although the form of delivery is different, the effect is the same. But when delivered through the tax code this spending becomes specially privileged. Withdrawing the support carries the stigma of being a "tax increase" and the provisions are not typically subject to as careful review as spending programs. Because tax expenditure programs are not subject to as careful scrutiny in general, they should be subject to special scrutiny by the commission. And, when balancing out the merits of competing priorities the tax expenditures in policy areas should be considered alongside traditional spending—not on a separate track. Finally, as the commission tallies up its proposals, tax expenditures should count on the spending side of the ledger not the tax side—it's a more accurate representation of what they are and how they should be considered in the budget process.

Taxes

Revenue increases will have to be part of any serious commission proposal. Doing it all through spending cuts is simply not practical or advisable. Once one carves out the spending programs that realistically won't be substantially cut in 2015 beyond current projections, such as Social Security, health care, veterans' benefits, and a variety of other programs, the level of cuts needed in the rest of government to close the primary budget gap would be irresponsible and wildly unpopular once the consequences became apparent—entailing average cuts of about 16 percent across most programs, including defense spending. To make meaningful progress in the fiscal outlook beyond 2015 requires additional revenue as well. Raising more tax revenues can, of course, have adverse consequences on economic growth. As of now, however, effective tax rates, especially on high-income earners, are at historically low levels. And the tax code today is riddled with loopholes. By international standards, we are a low-tax country. There is plenty of economic room for more revenue.

There is also precedent for this being a successful strategy. In 1993, taxes were raised under President Bill Clinton and the economy flourished. Economic performance in the post-1993 period was better than that seen during the eras of tax cutting under Presidents Reagan and Bush. Average annual GDP growth after the 1993 tax increases was 3.9 percent, but after the tax cuts of the Bush era was 2.5 percent. Investment growth after the Clinton tax increases was 10.2 percent annually, but only 2.7 percent after the Bush cuts. Similarly, income growth, wage growth, and employment growth were all higher following the tax hikes of 1993 than following the tax cuts under President Bush.

By all these measures, performance was also better after 1993 than after President Ronald Reagan's tax cuts. And, of course, after the 1993 tax increases large federal deficits turned into surpluses in sharp contrast to the experience following the Reagan and Bush tax cuts.[2] Additional revenues can and must be part of the solution, as they have been in the past.

Conclusion

The commission does, indeed, face an important and daunting task. It also, however, has a unique opportunity to bridge the distances that make the challenge of addressing the nation's fiscal situation so difficult. To achieve that will take all the members acting in good faith and making compromises. If the commission, collectively, can do that then it will indeed provide a valuable service to the nation—offering a credible path forward to the president and to Congress.

Endnotes

[1] Michael Ettlinger and Michael Linden, "Deal With It" (Washington: Center for American Progress, 2009), available at http://www.americanprogress.org/issues/2009/09/deal_with_it.html.

[2] Michael Ettlinger and John Irons, "Take a Walk on the Supply Side" (Washington: Center for American Progress and the Economic Policy Institute, 2008), available at http://www.americanprogress.org/issues/2008/09/supply_side.html.