

CENTER FOR AMERICAN PROGRESS

PROGRESSIVES AND THE NATIONAL DEBT: OPENING REMARKS AND CONSEQUENCES OF THE CURRENT FISCAL TRAJECTORY

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ROBERT GREENSTEIN: Good morning, everybody. If you could please take your seats. Welcome. I am Bob Greenstein of the Center on Budget and Policy Priorities. And welcome to the Center for American Progress, Center on Budget and Policy Priorities conference. Thanks to all of you for coming. We view this as a quite important conference, which we hope will lead to an ongoing conversation and much hard work.

As you know, today we are in the midst of the worst recession in decades. And the current level of deficits is not cause for alarm. With the economy weak, interest rates about as low as they can go, the government needs to be running significant deficits to keep consumption from falling off the table and the economy from sinking further. The current deficit is not the topic of this conference, but the long-term deficit is.

As most of you probably know, the Center on Budget and Policy Priorities regularly projects the long-term fiscal path using Congressional Budget Office estimates. And even allowing for the uncertainty of projections that go into the future, the conclusion is clear. If we remain on our current course with health-care costs continuing to rise at the rates they have in recent decades, the aging of the population and current levels of revenue – in other words, without policy changes, deficits and debt will grow to unprecedented levels that jeopardize the ability of the federal government to do its job and meet critical national needs and also pose risks to the economy.

The path is unsustainable with debt levels climbing to somewhere in the general vicinity of 300 percent of the gross domestic product by midcentury and interest payments on the debt gobbling up ever larger shares of the budget. And as a result of that, major policy change is inevitable. As the late Herb Stein once said, if something can't go on forever, it won't. And changes, sooner or later, big changes are coming. And we at CAP believe that progressives should be front and center in this debate helping to design ways to tackle it and to figure out ways to do so that don't destroy the village in order to save it, that don't cripple our ability to meet crucial needs. Hence, today's conference.

And what better way to start the conference than to hear, as we will now, from the president and CEO of the Center for American Progress, John Podesta. (Applause.)

JOHN PODESTA: Good morning and welcome. And on behalf of the Center for American Progress, I join Bob Greenstein and the Center on Budget and Policy Priorities in welcoming you to today's conference on "Progressives and the National Debt: Consequences and Solutions." We are pleased that there is some great interest in today's program.

I would like to start off by thanking Michael Ettlinger, who you saw just a minute ago, and Michael Linden for putting together this great report, which I think really states in very clear terms what the problem is and the problem that Bob described, which is a long-term problem, and our premise of today, which is that we need to deal with it.

And I also want to thank Bob Greenstein and CBPP for their partnership. This project actually began as a series of small-group conversations with CBPP and some other friends and led us to conclude that we must expand the progressive debate about these issues. And I don't think we can have a better partner than Bob.

I want to say a word about him at the outset. When he was awarded the Heinz Award for Public Service in 2008, he was described as respected on both sides of the political aisle, widely viewed as an unbiased authoritative expert on a range of fiscal policy and poverty issues. His work has helped improve the economic outlook of millions of America's poorer citizens. So fiscal realist and poverty advocate provide, to some extent, an unusual combination of perspectives, but in Bob's career, I think they belong together. For he will discuss in our first panel in a little bit it is the progressive perspective that brings us together today to discuss fiscal policy.

CBPP and CAP share a commitment to a robust growing economy, which can support progressive investments in health care and energy and education to not only spur long-term growth, but also to provide opportunity for all Americans. And so we come together as progressives to try to forge a shared approach to the national debt problem.

And we share a concern that the current fiscal path will undermine our ability to fulfill that vision. I actually can make this work. You will see on this slide there are some differences between CBO and OMB and there are some technical different reasons for that. But both show structural deficits above 4 percent and in CBO's case, rising as in the out years. That is not sustainable. It will mean that we will see an increase in the rise of the debt to GDP going to, again, long-term unsustainable levels.

But I want to reiterate one point that Bob made, which is we are not here to talk about the short-term deficit. While some would use current deficits as an excuse to stall central strategies to get the economy moving again, this conference's sponsors believe it would be a mistake to take actions to reduce the deficit immediately while our economy is still recovering from the worst recession since the Great Depression.

It is the long-term structural deficits and debt that pose the true challenge, not the numbers in the current year or next fiscal year, which resulted from responding to the crisis that the current administration inherited. We are just beginning again to be able to imagine a more robust economy that can support a long-term strategy to move towards greater balance. As progressives, we need to begin to sort this out ourselves before the conversation comes to us.

But first, let's understand how it came to this point. The administration's conservative critics argue that spending by the new administration produced outlook of deficits over the next 10 years topping, some would predict, over \$1 trillion annually. President Obama, of course, did take bold actions to stave off economic collapse and financial meltdown that he inherited. Unfortunately, the consensus is over the last nine months, the U.S. and the world have avoided what could have been a much longer and more severe period of economic decline. The president's \$787 billion stimulus package and related emergency measures succeeded in pulling

the economy back from the brink of disaster. But let's be clear. The great recession is itself a legacy of conservative reluctance to impose rational parameters on a Wall Street that was careening out of control.

Moreover, President Obama's necessary action to stabilize our economy only account for about one-sixth of the current deficit. More than 50 percent are directly attributable to policies put in place by the previous administration. And I believe, in my own view, that it is the result of 8 years of fiscal and economic mismanagement. That figure rises to over 70 percent when you account for the deep recession that occurred as a result of the economic policies pursued by the Bush administration.

Some of us, of course, can remember back to 1992, when the federal budget deficit was actually 4.6 percent of GDP and was projected to remain well above 4 percent for the following decade. I am joined here in the front of the room by some of my colleagues from the Clinton administration who entered office in early 1993, and began to grapple with that problem.

By 1998, President Clinton had turned what was supposed to be a huge deficit into a modest surplus, the first of 4 consecutive years of surplus that the longest continuing stretch in 70 years. I don't know of this works. I can't make it work. I would like to think that little dip below the red line, 1998 to 2001, were the Podesta years at the White House. (Laughter.)

And in 2000, the United States enjoyed its largest budget surplus since 1948. President Bush, in fact, inherited surpluses that were supposed to last for a decade. But his insistence on giving massive tax cuts to the very rich while waging two wars drove the federal budget into a giant hole, turning a \$236 billion surplus he inherited into a \$459 billion deficit, from a surplus of 2.4 percent of GDP in 2000, to a steady string of deficits culminating in this year's shortfall.

What does that mean for America's place in the world economy? During President Bush's two terms, publicly held debt increased by 75 percent or \$2.5 trillion. America's debt to China grew tenfold during those 8 years from 60 billion to \$630 billion. So we are going to spend a long time working very hard paying off the interest on that debt.

Other conservative failures also contributed to this gigantic hole. There was no serious effort to address the steady climb of health-care costs as a percent of our nation's gross domestic product. The Medicare prescription drug benefit was enacted, which is a good thing, but without any ability to pay for it or to, in fact, pose some fiscal discipline on the drug benefit itself by letting the government bargain for lower rates, these fiscally irresponsible policies did not only leave a lopsided fiscal legacy, they also produced tepid results when compared to progressive policies of the prior decade.

GDP growth during President Bush's 8 years was less than half of GDP growth during the Clinton era and produced only one-tenth as many jobs, 23 million jobs during the 8 years of Clinton, 2.5 (million) during the 8 years of Bush. And I think if you take account for what the job losses at the beginning of this year, which I think would be fairly attributed to the previous administration, you probably ended up as a net job loser.

Middle-class income growth stagnated in comparison – median income increased by \$6,000 adjusted for inflation in the 1990s. So I think we can sum up the record this way. Progressive economic policies delivered results. Conservative economic policies delivered disaster. Unlike his predecessor, President Obama has expressed his commitment to the deficit reduction and fiscal responsibility. I think he is following through on that. His current budget plan actually lowers the long-term deficit compared to business as usual.

One of his first actions was to scrap the Bush administration's policy of hiding major government spending initiatives like the \$900 billion spent on the Iraq war and the sun-setting of tax cuts to sort of hide them off the federal balance sheet. Instead, I think he has put forward honest accounting of government spending.

And the president and his team have correctly indicated, I think, that health-care reform must be the first step in putting the country on a sustainable fiscal footing. It has been clear for years that health-care costs have severely been hurting both the country's balance sheet and family bottom lines. During the previous administration, the largest categories of federal health-care spending increased by almost 90 percent, an increase of .9 percent of GDP and are on track to equal 6 percent of GDP 10 years from now, almost twice the amount spent on defense if we have no reform. And the average household's premium has more than doubled over the last decade with 62 percent of bankruptcies now contributing in part from medical bills.

You will hear later from David Cutler who has analyzed the massive swing not only in federal budgets, but in family budgets that a successful health-care delivery reform can produce. On the federal side alone, we can see savings of 3 percent of GDP just by having the health-care industry achieve productivity gains that are average in the U.S. economy. If we can just achieve in the health-care industry average productivity gains, we can reduce the projected federal budget by 3 percent of GDP.

The administration is also working to capitalize, I think, on economic benefits of transitioning to clean energy economy. The bill recently passed in the House the American Clean Energy and Security Act along with clean energy provisions in the stimulus bill that passed in February would create 1.7 million jobs. The investments in that bill and in the recently introduced Kerry-Boxer bill are fully paid for – they do not add to the deficit. And it is clear that we need to be a global leader in the clean energy industries of the future to create stronger job growth.

Apart from these two cornerstone initiatives, the president is also committed to reinstating pay-as-you-go rules in Congress and rolling back President Bush's tax cuts for the wealthiest Americans. All of these policies are critical steps in the right direction. I think they have laid the groundwork for keeping long-term deficits under control while supporting economic recovery. But long-term deficits still remain a serious problem even after all of that work has been done. And as others will describe, have the potential to be dangerous if we don't take steps to address them when the economy fully recovers.

For those reasons I mentioned earlier – for the reasons I mentioned earlier, I think President Bush's profligate economic program and market fundamentalism in the economic and

financial crisis that arrived upon its conclusion to the lesser extent the emergency measures that were necessary to pull our economy back from the brink, avoiding the negative consequences that could result from sustained long-term deficits, pose a daunting challenge. There will be hard choices to make. But now is the time to prepare for making them.

The scale of the challenges we face there, you know, including that uptake in the line at the back end of this decade with respect to the deficit and therefore the increase in the national debt, provide no easy answers. It will likely require a balanced approach that includes a variety of contributors. And we have organized the conference to talk about many of these.

But first and foremost, as I said, bending the curve on health-care costs as part of comprehensive health-care reform is critical. And beyond health-care reform, further reforms to entitlements, sustainable and affordable national security strategies need to be implemented, a renewed commitment to setting priorities, only spending taxpayer dollars on programs that work and a smarter, more productive government that makes the most of every tax dollar.

Finally, and it has to be part of the discussion, we need to talk about revenue as well. If you look at this graph, the gap between what we are spending and the revenues of the federal government is wide indeed. And there are disagreements amongst progressives about how much to even focus on this problem. But we can't make the kinds of investments that are included in that trend line while we continue to have revenues that are below by at least close to a percent what we were looking at in the boom years, I think, particularly of the late 1990s.

So I hope this conference can begin can begin to identify where there is common ground for progressives, help us all to focus on what we need to do to protect what matters to us most, the investments that we need and to put this discussion in further context and a bit of a political context, we have asked someone who almost needs no introduction to provide preliminary comments before we move to our first panel.

Charlie Cook is the publisher of the Cook Political Report and political analyst for the National Journal Group and NBC News. He is authoritative, non-partisan and prescient. Charlie Cook is the perfect person to help us see through the eyes of elected officials the perils of both ignoring and of addressing the national deficit and the national debt. So please join me in welcome Charlie Cook. (Applause.)

CHARLIE COOK: Thank you, John, for that nice and generous introduction. You know, looking at the agenda and seeing, you know, just such brilliant, substantive people like Alan Blinder and Roger Altman and Laura Tyson and Jackie Calmes moderating the discussion, as a political hack, I feel a little like the turd in the punch bowl. (Laughter.) But I appreciate the opportunity to be here.

After spending the better part of 3 years talking about how horrible the issue agenda and circumstances were for Republicans in 2006 and 2007 and '08, it is a little disorienting to be preaching sort of doom and gloom for Democrats. But I think we have suddenly found ourselves in a situation where the Democratic Party is in some pretty serious trouble here. And you don't have to look any farther than just simply party identification. Every month, the Gallup

Organization does 30,000 interviews in their national surveys. For those of you who are curious, the margin of error on 30,000 interviews is less than six-tenths of 1 percentage point.

The Democratic Party advantage over Republicans in leaned party ID dropped from 17 points in January to five points in August. That 12-point drop in just eight months is one of the sharpest probably – actually, I think it is the sharpest I have ever seen in such a focused period of time. And at the same time, just looking at President Obama's numbers and to think that he was basically in terms of weekly Gallup approval numbers, you know, above 60 percent – at or above 60 percent through the end of June – and now sort of drifting down into the low 50s with 52 percent last week, 52 percent through Monday night.

But the thing is – the important thing to look at or to think about is not necessarily the overall numbers. Look in blue America, blue Democratic, left-of-center America, the president is still in great shape. I mean, his approval ratings are still in the high 80s, which is fine – down a touch, but nothing to worry about. Red America, they don't like him. They don't like anything he or other Democrats are doing. They are a write-off anyway. They don't matter.

But it is purple America; it is Independent, moderate, purple America. Those are the people that give a president what Austin Powers would call his mojo, you know, that special sauce, that special oomph, that special clout that allows you to get things done.

And for the president, through mid-June, his numbers were above 60 percent among Independents. But now they have been pretty, since mid-July, consistently below 50 percent. Among seniors, the key demographic, 65 years of age and older, key demographic in a midterm election, under 50 percent since mid-July. Among non-Hispanic whites, he was in the high 50s through Labor Day, now below 50 – first below 50 and now in the low 40s since August.

And so we are looking at a real sea change in attitude since, say, Memorial Day in terms of the president's numbers. And it has sort of robbed him; it has stripped him away of a lot of clout that a president needs to get through a strong agenda.

And the thing is while it is true – it is important not to dwell too much on the president's numbers because while yes, his name is not going to be on the ballot in 2010, but the thing is midterm elections are about referendum on the party and the power and whether it is the power in the White House or the party controlling Congress. But the thing about it is President Obama, at least in purple America among Independents, there is a reservoir of goodwill towards him. They don't necessarily agree with him on policies, but they like him and they wish him well, which cannot be said in red America.

But the thing about it is that reservoir of goodwill for President Obama that does exist in purple America among Independents does not exist for the Democratic Congress. And that is where there is separation here that is very, very, very important. He has a little protective coating that helps some. They do not have that protective coating.

While the president's numbers have resiliency – appears to have resiliency, theirs do not. So what has happened that has caused this enormous shift to occur? I think last year, while most

all the people in my world were completely fixated on the presidential race – and after Lehman Brothers defaulted, you know, yeah, we kind of got sidetracked for a week or two on the economic and financial sector. And then we immediately went back to the final run on the presidential and all of that. But I think something big and deep psychologically started occurring that I think a lot of us didn't start sort of realizing until maybe even the middle part of this summer.

You know, Americans in the best of times or I should say red America, they think all government – except in your bedrooms – (laughter) – they think all government is always bad, okay? And in blue America, they think it is pretty much good all the time. But so I am sort of focusing my comments more on purple America. In the best of times, there is a healthy skepticism about the efficiency and efficacy of the federal government. After Hurricane Katrina, after the first half of the war in Iraq and a lot of the civilian decisions that went into that, it was particularly low.

After the regulatory failures, the systemic failures of the system that should have prevented the economic debacle from last fall didn't occur; it was at a particularly low point. And I think that at that point when I look at it personally, I see it that President Bush basically went – and it is not fashionable to say nice things about President Bush – I realize that – but I think it is as if he went to Ben Bernanke and Hank Paulson and said, guys, this is over my pay grade. You guys figure out what it takes and whether it is chewing gum or rubber band or paper clips or trial and error, you do what it takes to save our financial system from going off the cliff and I have got your back.

Now, I am convinced he was probably reaching for the Oval Office trashcan twice a day to heave for what had to happen, but the thing about it is what happened in the last four months of that administration and I would say the first four months of this administration did, in fact, keep the U.S. economy from going off a cliff and yet, what really was a success following a failure, a success of government to prevent a second Great Depression is seen as a failure in the minds of regular people and particularly purple America.

They look at TARP, bailouts, takeovers, they look at all this with horror when the reality is it was a success story, albeit it an unpleasant one, but it was a success story. And purple America, let alone red America, sees it as this great power grab and that government is expanding in a potentially irrevocable, irreversible way and that it is scaring the heck out of them. Again, I am talking about red and purple America, not blue America.

And we are seeing it very clearly in the data. For example, Gallup Organization at least about a week ago, the question that they have asked for years and years: Some people think the government is trying to do too many things that would be better left to individuals and businesses. Others think that government should do more to solve our country's problems. Which comes closer to your view?

The view that government is doing too much hit 57 percent a couple week ago, the highest in a decade. We saw the same kind of thing in the NBC/Wall Street Journal poll where they ask a similar question. In as recently as July of 2008, 53 percent thought government

should do more; 42 percent thought government was doing too many things. Now we have got a plurality the other way – 45 percent think government should do more; 49 percent think government should do less. But a fairly significant shift in just over a year's time.

And now, the thing is it is not that red America shifted or that blue America shifted, but purple America shifted. And that is the key point in this election. And I think maybe a mistake that the president may have made – President Obama may have made – was that maybe if he had come in and said sort of this benevolent gesture of paying a compliment to President Bush and say what those folks had to do in the last four months of that administration and what we have had to do in the first few months of ours, no president in their right mind would ever want to do. You would never want to do this, except if that is what it took to keep our financial system from going over the edge.

And I think by making that sort of generous gesture, he would have been providing a framework because frankly, I think the American people do not realize how close we came to going off of the edge. Now, how serious from a political standpoint is the situation right now? If you think about the majorities that Democrats built up in 2006 and 2008, think of it as a greenhouse where you would be growing orchids and tropical plants, the soil, the water, the temperature, the sunlight, everything perfect, everything optimal.

And if you look at 2006, 2008, you had a stream of scandals: Abramoff, Ney, Tom DeLay, Mark Foley to name a few. The war in Iraq was going horribly. The time for change, the 6-year itch dynamic that you normally see in second-term, midterm elections. It all came together and exploded on Republicans with those Independent voters I was talking about siding for Democrats by an 18-point margin. And Democrats pick up 31 seats in the House, six seats in the Senate and control both chambers.

Then fast forward to 2008. And while the war in Iraq started getting better, the economy was getting worse. The time-for-change sentiment continued to build. Doubts about Sarah Palin, the surge of young and minority voters, again, it created optimal conditions for Democrats and they picked up still more seats in the House and Senate.

And so you have got a majority that is built under absolutely perfect growing conditions. And what is happening now on a thematic level is it is as if a big wind has come along and blown that greenhouse away just as winter is starting to come. And so it is a difficult, difficult situation.

And you think about it. Democrats in the House, the margin is 40 seats. Democrats have 84 House Democrats. Eighty-four are sitting in districts that went for either George Bush in '04 or John McCain in '08. Forty-eight of them went for both Bush and for McCain. Fifty-four Democrats are sitting in seats that were held by Republicans just 4 years ago. When you look at where this intensity, this animosity towards the Democratic Party is most high: in the old confederacy. There are 22 Democratic seats that are vulnerable or potentially vulnerable just in the confederacy. That is half of their margin in the House of Representatives.

The bottom line is – and I find myself stunned to be thinking this is I think there is at least a one in three – somewhere between a one-in-three and a 50-50 chance that Democrats are going to lose the House of Representatives next November.

Now, some of you may be thinking that is 13 months away. It is way too soon to be making a hard prediction. And I am not making a hard prediction. But I am saying is we are on a trajectory to call for a very close call on the majority in the House of Representatives.

Now, could things get better? Sure, they could. Yeah, the economy could turn around. I think the economy will turn around. But is employment really going to turn around by November of 2010? Wow, not that much. And even to the extent the economy gets better, does anybody think that Afghanistan is not going to get worse even if you believe that in the end, it may get better? Does anybody actually think that?

So yeah, things could get better in the next 13 months. But they could also snowball and get a lot worse. And even in the U.S. Senate, the sobering thing for Democrats is once you get past this election where there are 19 Democratic seats up in the Senate and 19 Republican seats up, in the next two elections, in 2012 and '14, there are 43 Democratic seats up and only 22 Republican seats up.

Democrats thought, had good reason to believe at the beginning of this year with seven Republican retirements in the Senate, they had good reason to believe that they might be able to pick up – add a cushion of two or three more Senate seats on that they would desperately need in 2012 and '14. But the thing about it is now with political circumstances having changed so much, I think it is more likely that Democrats are going to lose seats rather than gain a few seats – not that many, but a few seats in the U.S. Senate, which means that you are going to walk into '12 and '14 in an even more eroded situation.

So this is – you know, could things change? Yeah. But this is a very, very, serious, serious situation. And I think it tracks back to this sort of whole role of government thing. Now, if you believe – and a lot of my friends in the White House are absolutely convinced, once the economy turns around, the political fortunes will turn around. Things will get better.

But if it is not – and if you just believe that the problems are related only to the state of the economy, then they are right. They are probably right. But if it is something bigger, something larger, if these purple Americans see what has happened over the last year as this dangerous encroachment, as they do – and I think they are crazy, but that doesn't mean they don't feel that way.

And let me just close. Any of you who is skeptical about any of this, talk to some of the Democrats that are in tough districts. Find a Democrat that is in a district that went for John McCain. Find a Democrat that is in a district that went for George Bush in '04, and ask them, how are things going? And the typical thing you are going to – here, I will give you one example. This Democratic congressman from the South never had a difficult race. His married daughter lives in his district. His married daughter and her husband don't go out to dinner

anymore because when they do, they get completely trashed because people know that she is the daughter of the incumbent Democratic congressman in that state.

I have had other members say it is the worst they have seen since 1994. There is a visceral ugly thing going on. And when you listen to those town meetings last summer back in July – and granted, those people are crazy, no question about it. But listen to them. And once you got past the death panels and once you got past abortion, what you heard, it wasn't about health care; it was about role of government.

And these people – it may not be justified at all. It may be crazy. But they think so and they are the people that are going to decide whether Democrats hold on to their majority in 2010 or not. And this is, you know, go out and find a pollster. This is a very, very serious situation. And I think the Democrats, at least whether it is rhetoric or substance, one or the other, they have got to be mindful of what has turned a 17-point advantage into a five-point advantage in such a short period of time. And think about it. Why has this happened? What have we done to trigger this? And what can we do to offset it?

And I think that this conference is, you know, from what I could tell, it is going to go a way toward sort of sensitizing people that, wow, these really are big things. And part of it is budget; part of it is role of government. But for Democrats, this situation, I think, it is as serious as a heart attack.

But thank you very much for having me come. Thank you very much. Have a great day. (Applause.)

MICHAEL ETTLINGER: Thank you, Charlie. I am Michael Ettliger. I am the vice president for economic policy at the Center for American Progress. We are going to go from those cheery remarks – (laughter) – to discuss the consequences of the current fiscal trajectory, which will be an equally cheerful discussion, I imagine.

To moderate that, I would like to introduce Jackie Calmes of the New York Times. She is the national correspondent with the New York Times with a focus on the interaction of politics and economic policy. Previously, she had been the chief political correspondent for the Wall Street Journal's Washington Bureau. And during her 18 years at the Wall Street Journal, she covered the White House and Congress, focusing mostly on budget and tax legislation and also reported on congressional and presidential election campaigns, as well as issues confronting state and local governments.

So if that panel could come up, we will get started.

JACKIE CALMES: I like how Charlie ended his depressing progressives and Democrats speech with have a good day. (Laughter.) And you said it in total seriousness like it wasn't – (chuckles) – even ironic.

It is great to be here in front of such a big crowd. When they first asked me, I was a little bit hesitant as a journalist because it was associated, you know, mainly it seemed with one party.

But I think this is – progressives is something, I would think, somewhat separate from the Democratic Party, as the Independents, if you talk to many of them, would indicate. And this panel, to be associated with this panel is an honor. And I think people and I know people on both parties respect what they have to say.

And I will quickly introduce them, so that you can hear from them because you didn't come here to hear from me. Bob Greenstein, as you already have heard, is the director of the Center on Budget and Policy Priorities. And I have to say. After covering the budget since 1984, off and on for CQ and the Journal and now the Times, I don't know what we would do without the center. I really don't. And, you know, CBO and the OMB both have some great resources. But without the center sometimes to arbitrate – (chuckles) – and really for what we always have to describe as a left-leaning group or liberal – whatever the editors are insisting on at the time – it is always respectable.

And Alan Blinder, professor of economics at Princeton University, who I have also called on from time to time, both when he has been in government and out. He was a member of Clinton's original CEA, Council of Economic Advisers, and then vice chairman of the Fed.

And Laura Tyson, professor at Berkeley. And I have to say, I took my daughter to Berkeley two weekends ago and had not done my homework to know what out-of-state tuition costs now. (Laughter.) And it is going up 32 percent because of budget cuts. I wasted a whole trip. (Laughter.)

LAURA TYSON: Would you like me to adopt her? (Laughter.)

MS. CALMES: Laura is the former chairman of the Council of Economic Advisers and former director of President Clinton's National Economic Council. And so to go straight – I am going to start by going to Bob to find out – you are going to go last? Okay. All right. So let's see. Who do they want me to go first to? All right. The man in the middle. Of course, makes sense.

Alan, the topic of this panel is the consequences of our current fiscal trajectory, which I have now got a, you know, get save button that says unsustainable. It seems like not a week goes by that I don't use that adjective about two or three times.

How much should we be worried about the current budget deficit and the potential limits of the Treasury's ability to float this debt?

ALAN BLINDER: Not very much. You are starting to hear even some market people, some political people, some in the commentariat talking about potentially reaching limits. And we saw the deficit-to-GDP ratio is like 11 percent, which we haven't seen since the Second World War. It is an extraordinary number.

But you have to realize how much of this comes from the recession and the efforts to fight the recession and in consequence of that, will go away by itself. Now, that will still leave us a substantial deficit problem. And as, you know, Charlie Cook sort of finished his remarks by

saying have a nice day. I am tempted to start mine by saying have a nice decade. (Laughter.) This is not over when the recession is over. And while I am not at all worried about the short-run deficit, even though – if you had asked me 10 years ago, would I ever in my lifetime see an 11 percent of GDP deficit, I would have said no way. But I am not so worried about that.

But we have a huge long-run deficit problem. Now, we have had this long-run deficit problem for a long time. And the way I think about it is that the year 2010 has been fixed in the calendar since the year 1. So in 1980, we knew about the year 2010, but that was really far away. It is now 2009. The year 2010, by the way, is what you get when you add 1945 plus 65. So you get all the 1945-plus babies start being eligible for Medicare, a word that I will come back to in a moment.

So 2010 is here, basically. So the long run is now the short run. And they are combining. So we do need to think seriously about getting some fiscal discipline. But as the old saw goes, you know, we want virtue, but not quite yet. We don't really want it in the year 2009; we don't want it in the year 2010. I am not sure whether we will want it in the year 2011. We might. That depends how the economy goes.

I mentioned Medicare and Medicaid. Peter Orszag has put the phrase bending the curve into the national lexicon. And somebody – I think John – used it earlier. I just want to make one point about that. I don't fancy myself a health-care expert, although all of us who survived the Clinton wars of 1993 and '94 feel a little bit like we are – (chuckles) – health-care experts. But I just want to make the point that when you look at the numbers in the CBO projections, the OMB projections, the center's projections, it doesn't matter. They differ in details. They all carry the same message. You can actually simplify the long-run budget problem – I am not talking about this year's huge deficit – the long-run budget problem by saying Medicare and Medicaid.

That is about it in the sense that if we can bend the curve effectively – by the way, downward – (laughter) – it has been easy to bend the curve upward. If we can succeed in bending the curve downward, then we are going to get control. We are going to solve this long-run budget problem or at least most of it. If we cannot, we will not. It is that simple. There is nowhere anywhere else in the budget where you can make as serious a dent as needs to be made in the long-run fiscal imbalance, nowhere. It is only in health.

Now, the big problem in that, which I would love to hear David Cutler or Judy Feder or somebody contradict me on later, is that nobody knows how to do that. Without going into it, I would say there are lots of sensible ideas in bringing down health-care reform. As far as I can tell, they all have to do with the level and not with the growth rate. And that is welcome. I mean, we are spending so much on health care. If we knock something out of a level, we should want to do that. I don't see much curve bending in the long run, though I would love to be proven wrong.

The last thing I wanted to say in answer to your question, Jackie, is to bring back Stein's law, which Bob mentioned. Between the two of them, they stole all my thunder. Herb Stein said that if something cannot continue forever, it will stop. If you look at those – this, I think, is at your place. This is the center's – and you saw in the chart a couple of deficit-to-GDP ratios.

What are you seeing there? You are seeing the chart of what a mathematician would call an unstable path. It is something shooting off to infinity rather than coming to a stable position like a pendulum does. And so if you stop it at 2020, it looks bad. If you stop it at 2050, it looks horrible.

The CBO has gone up to 2080, where it looks beyond absurd like the Earth has become Mars or something like that. What is that telling you? It is telling you we cannot possibly go there. That is the forecast of something that cannot possibly happen, completely impossible. So the question is, since it can't go on forever, what is going to stop it? What will give?

I think there are two basic candidates. It is the economy or the political system. And let me just finish by giving a couple of quick remarks on that. If it is the economy that gives, what does that mean? Some people think inflation. And if you look at the history around the world, not in the United States, off reactions to massive public deficits, inflation is the thing you see more often than anything else. I don't think we are going to see that in the United States. That would be a huge abdication of responsibility by the Federal Reserve and I think it is extremely, extremely unlikely.

And by the way, at least as far as you can see that in the markets, in the Treasury inflation – TIPS, Treasury Inflation-Protection Securities, the market things that also. Now, they don't go to 2080. But as far as you can see it, they believe that. So I don't believe it is going to be inflation, though that is a small probability.

Interest rates are a very obvious candidate, especially long-term interest rates. And higher long-term interest rates, which are a likely consequence of large budget deficits, have their consequences on trend growth. It is not about business cycles; it is about the trend growth. And that can add up over a long period of time. And that is a concern.

I would put at the top of my list, though, in terms of probabilities, the dollar. I think if the economy cracks, it cracks on the dollar basically. And I would say the longer we stay on this explosive path, the more likely a crack in the dollar is. I am going to leave most of that topic to Laura who I know wanted to say a lot more about current account deficits in China, I guess, and things like that. So let me just drop that on the table and leave it at that.

The other place this can crack is in the political system. You know, I think of the New Deal that way. I mean, the system was breaking up and the political system cracked – cracked in a good way, I think. Political systems can crack in good ways and they can crack in bad ways. But I think that is the other possibility. And I wouldn't even begin to try to forecast under that heading what it means for the political system. But one of those two has to happen.

Unless – I come now finally to the third alternative – we actually look forward a little – I know this is a very un-American thing to do, at least un-American politics thing to do and look forward and say, you know, we don't really want the economy to crack. We don't want the political system to crack. And wouldn't it be smarter to do something about this deficit soon?

Last sentence. When I say soon, I mean, don't take the actions now. We don't want to have thoroughgoing deficit reduction in 2009, 2010. But it is not beyond the imaginable that we could actually legislate or otherwise pre-commit the system to reduce the deficit later when the economy is healthy. I just want to – it is the last thought.

MS. CALMES: I really wonder whether the political system is capable of addressing the scale of problems we have at this point. But that is grist for another panel. Laura, what are the implications for this projected deficits and debt in the next 10 years? And will the rest of the world be willing to continue financing our debt at these low interest rates, long-term real interest rates?

LAURA TYSON: I think you can begin this discussion, distinguish between the – call it short term, the medium term and the long term. Unfortunately, you don't have very good precise measures of what that difference means. But I think when we are talking about the short term up here – at least I and I think Alan are thinking about, you know, the next couple of years, where frankly, we haven't talked about the underlying economic assumptions. But I am in the camp that believes that the underlying economy – both the U.S. economy and the global economy is likely to remain pretty weak.

And it is for reasons having to do with we are in a balance-sheet recession. Balance-sheet recessions don't get over quickly. Consumers are not going to recover quickly. They are not going to rebuild their wealth quickly. The unemployment rate is not going to recover quickly. We are going to have substantial impediments in the credit markets and in the capital markets.

And I think that that means that we are going to have a relatively slow recovery with a substantial amount of downside risk. And I frankly do worry about the fiscal drag next year as the stimulus begins to slow down. And then, of course, more fiscal drag in 2011, when the tax cuts are rolled back. So I think that we need to say that there is a real balancing act here in the short term between taking action on the deficit too soon, which really will, I think, risk undermining recovery and trying to build a sustained recovery with momentum.

Now, the long-term issue, the 2030, 2050, 2080, I have nothing to add. These are unsustainable paths. And the sooner we get on a path – on a pre-committed solution to that, the better we are because these long-term deficits do seem – the evidence by Peter Orszag and many others do suggest that long-term deficits do have an effect on long-term interest rates. It does slow down trend growth. And frankly, it is less painful to take action very slowly and gradually to deal with a problem that is 10, 20, 30 years out. It is much better to do it now, begin to do it now by setting up a pre-committed path. And then when the economy has become a strong robust recovering economy, begin to introduce that.

So the medium term, I see, is somewhere through the next decade. Let's assume we get out of the recession, we don't have a double dip, we have an anemic recovery for several years, we have unemployment rates above any measure of full employment, we have a lot of underutilized capacity both in the U.S. and by the way, we will have it in Europe as well. So we

end up with these 4 to 5 percent budget deficits in the medium term. And we end up with debt to GDP going to 80 or maybe the IMF says 100.

Well, is that sustainable? Will the rest of the world help finance that? At what interest rate might it be financed? And I think that that forces us to look back carefully at what just happened. What just happened is we had a period, 2002 to 2008, where the U.S. went on a massive dissaving binge. And actually, we focused on the budget deficit here. But the household sector went on a dissaving binge. The household savings rate went to zero. And households accumulated massive amounts of debt relative to their income.

Why did they do this? Well, in part they did this because the rest of the world was perfectly happy to finance this. It was perfectly happy to finance this. Despite a significant increase in U.S. borrowing from the rest of the world as measured by a current account imbalance, which went up to 7 percent, we had abnormally low real long-term interest rates by historical standards. Yields on fixed-income assets, government bonds, corporate bonds, securitized debt all fell because there was a global savings glut. I do believe that hypothesis.

There were huge amounts of foreign capital made available to the United States, to all kinds of borrowers. It was mediated mainly through China and others buying U.S. Treasury securities. But believe me; that affected the price of all of the other fixed-income assets.

So we were going on our way able to finance our deficit and our personal collapse of savings with rest of the world funds. Why was the rest of the world doing this? Well, they were actually trying to accumulate a lot of foreign exchange reserves to insure themselves against another foreign exchange crisis like 1997, 1998. So part of this was insurance for them. And part of it was essentially using an export motor to drive capacity, development and growth.

And, of course, the country we always think about here is China. And just let me give you something amazing numbers because I see 2002 and 2008 as a bubble of many types. And one bubble was the savings bubble in China and the export boom in China. Another bubble is the U.S. housing boom and the collapse of personal savings financed by the Chinese primarily.

Between 2002 and 2007, China's exports grew at nearly 30 percent a year. China's investment grew at 25 percent a year. China's exports plus fixed investment hit 60 percent of GDP. Out of history, there isn't a precedent for that. You can't find it in Japan. You can't find it in Korea.

China went from a current account balance, a balance – essentially, it did not have a surplus – in a few years to about 10 percent current account surplus. That is 10 percent of that GNP being pumped into the rest of the world as savings. And what did they do with that? They bought dollars. They had no reserves to speak of in 2002 and now they have \$2 trillion of reserves held in various things including dollar securities. And frankly, they are caught in a dollar trap. So every time you hear them talk about U.S. interest rates, U.S. exchange rate, U.S. inflation rate, yeah, they are trapped all right. They chose to run an export-driven economy and build up these reserves. And they chose to hold them in dollars. They chose to hold them in dollars.

Now, going forward, what does this say about our ability finance the debt? Well, I think a couple of things have really changed. And I was very impressed by what happened at the G-20 meeting at the announcement. The first thing that changed is the U.S. consumer, the U.S. household. Sadly, because for many of these households, their median income hasn't gone anywhere in years, they are saving more. And it is my hypothesis that they will continue to save more. They have lost trillions of dollars of wealth. They have lost income-generating capabilities. Their savings rate is zero. Their debt-to-income levels are still highly elevated. They have to save. They have to save.

So while government dissaving in the U.S. is going up – excuse me, government dissaving is going up, personal saving in the U.S. is going up. And if the U.S. household sector does get back to a steady state, several years of household savings rates of 6 or 7 percent, you know the U.S. government can finance a fiscal deficit of 4 to 5 percent with a U.S. current account imbalance of only 3 percent.

The U.S. current account imbalance is down. It is down by half already. So think about this. Part of the savings comes from U.S. households. They are saving more. The government is saving less. What about the rest of the world? What about the rest of the world here? Well, there are two scenarios. One is the Chinese do – and other countries follow them as well – shift to more domestic demand-driven growth. Their current account surpluses come down. They have less savings they are generating to us and to the world. But they also don't depend upon us as much anymore for consumption. That is actually a good scenario because while we will be growing more slowly, they can pick up some of the slack by growing their domestic demand.

The most worrisome scenario I see for the medium term is the following. The U.S. government is running a deficit of 4 percent. U.S. households are saving. The current account is down. But the U.S. is not growing very fast. And by the way, neither is much of the rest of the world because China doesn't deal with its savings glut. So there is still a savings glut in the world. Long-term real interest rates are still low. But the world isn't growing very fast either.

And I think that, to me, is a scenario we have to take as a serious scenario. Stephen Roach, who studies the Chinese economy a lot, has argued it will take 3 years and more likely 5 to 10 years for China to fill the global demand void that has been created by a reduction in the U.S. savings gap. Okay? If the U.S. savings gap comes down from 6 percent of GDP to 3 percent of GDP, that is the current account imbalance. There is a sucking in of demand from the rest of the world. Where does it come from? If it takes China 3 to 5 years to make it up, the world is going to be a slower place.

During this period of time, the most important thing the U.S. can do to try to make sure that our foreign creditors, as they bring down their own savings glut, are willing to continue to finance what we need, which will be less as a share of GDP, the most important thing we can do for these creditors, as well as for ourselves, is pre-commit to a long-term deficit reduction policy. We need credibility with our foreign lenders as they begin to move their savings home and that credibility would come from a program now of gradual deficit reduction for the future.

But I don't think given the increase in personal savings in the United States and given the availability of savings in the rest of the world that we are going to see either a precipitous decline in the dollar or a dramatic spike in interest rates if the U.S. runs a deficit of about 4 percent. I don't think it will be fun. I don't think it is advisable. I think the world economy will be weakened by that. But frankly, I don't see either a collapse of the dollar or a spike in real interest rates. I do see long-term decline in the dollar as a possibility.

But let me just end by saying when the imbalances were at their peak in 2007, the predictions were it would cause either a spike in the dollar – I mean, excuse me, a spike in long-term interest rates or a collapse in the dollar. That is how the imbalances would be corrected. What people didn't predict is what actually happened, which was a collapse of the financial markets through a variety of different means. So it is very difficult to make these predictions. But my prediction would be as I said. Thank you.

MS. CALMES: Bob, to tie this outlook to the purposes of this conference, what is at stake for progressives who care about things like poverty programs and income inequality?

MR. GREENSTEIN: Is this on?

MS. CALMES: I think it is on.

MR. GREENSTEIN: The green button is very subdued. (Chuckles.) Just before I start answering Jackie's question, I can't help but note that the room looks different than it did when I got up an hour ago. I know traffic was unusually bad this morning. And now we are packed to the gills. And it is just leading me to think – and I just want to take 30 seconds and say a word that my hat is off to John Podesta and the Center for American Progress team in the terrific job they did in conceiving and promoting this conference. It has been our pleasure to be their partner in working with them on it. In a word, CAP's high reputation is well-deserved.

As I noted when I first got up, we at the Center on Budget periodically issue new long-term fiscal forecasts. We have just completed a new one. It will be out in the next few weeks. Let me commend Jim Horney and the budget team at the center for all the hard work in putting it together. And I just want to share a few tidbits from it because it really sets the stage for my comments, Jackie, in answer to your question.

As I noted before, if you continue current policies without change, the debt held by the public rises to somewhere in the rough vicinity of three times, 300 percent of the gross domestic product by about 2050. And deficits look like they are in the range of 20 percent of GDP in that period. And this is all unprecedented.

As Alan noted, by far, the biggest driver of this is the rising cost of health care, the loss of revenues from extending the Bush tax cuts also contribute. Social Security is also a factor, but it actually rises fairly modestly as a share of GDP between now and 2030, and then stabilizes as the demographic changes abate. So unlike Medicare and Medicaid, Social Security does not relentlessly rise faster than GDP.

Part of the reason I am mentioning this, if I could have the first slide, please, is that what is often not recognized is that all federal spending other than Social Security and Medicare, Medicaid and interest payments on the debt has actually been declining modestly as a share of GDP for several decades and is projected to continue to do so. That is the blue slice at the top of the chart. Contrary to an often-heard phrase, we do not have a general entitlement crisis. We have an issue with the big three, Medicare, Medicaid and Social Security, and especially, as Alan said, with Medicare and Medicaid and with revenues.

Now, why should we really focus on this now? Well, in a nutshell, we can either try to shape the inevitable response or we can have it imposed upon us. I very much agree with the economic analysis that Alan and Laura have just gone through about the economic consequences of remaining on the current course. Some people disagree. It is hard for me to understand how if the debt relentlessly rises significantly faster than the economy decade after decade, you don't ultimately get some significant economic consequences.

But the point I want to make here is even if you disagree with that – I know there are some people who disagree with that economic analysis – even if you disagree with that, in a broader political sense, I am afraid it doesn't matter because financial and international markets and as a result, the political system, are not going to let us stay on the current course forever.

If I can offer a personal memory, I still remember the day in February 1980; I was running the food stamp and other food assistance programs for President Carter at the time. President Carter had brought out his budget that had a deficit of what was it, 16 billion, 13 billion, 30 billion? Something too small to remember the number in terms of current numbers. And I remember getting the phone call saying, Bob, the bond markets have trembled. The president is redoing his budget. You have 48 hours to give us X billion dollars in food stamp cuts.

Think of this year as another example. At the beginning of the year, President Obama said health care should be paid for. I can tell you that when I went on to Capitol Hill and talked to key committees in March and April, and I would say, you know, how are you thinking about the offsets to pay for it? After discussing some ideas, people would say, you know, at the end of the day, politically we are not going to come up with enough offsets to cover the whole thing. We will pay for what we can. The rest of it, we won't pay for.

Then came May with some reaction, some developments in financial markets that unsettled people. The president toughened his rhetoric and basically said I will not accept the health-care bill that increases the deficit. And when I went to talk to the same people on the Hill, there was a sea change. And the only discussion was we must fully pay for every dollar and cost in the health-care bill.

Now, these were market responses to fiscal outlooks much less daunting than this long-term path we are discussing here today. And it takes me back to my bottom line. We can either try to shape the response or we can have it imposed upon us. What are the consequences of having it imposed upon us? Well, for those people and those progressives who are particularly

interested in investments – if I could have the second slide, please – lots of investments, of course, are in the discretionary, the non-entitlement side of the budget.

Can I call this attention to your chart that only goes through 2019, only through 2019? Look at this. Interest payments on the debt are \$177 billion this year. Under the current policy course, they are projected to hit \$900 billion in 2019. Now look at the blue bar – \$584 billion in non-defense – that is both domestic and international – discretionary spending.

The \$671 billion in the blue bar in 2019 is a merely mechanical extrapolation of the '09 level adjusted for inflation. Does anybody in the room think there would really be \$671 billion in 2019, if we are paying \$900 billion in interest payments on the debt? If we drift, ultimately there is some crisis or perceived crisis. And deficit reduction is imposed without a very careful plan that very much involves people with progressive values.

The risk is high that the people with the least political power in this country bear a disproportionate share of the burden, even though, by and large, they are lower on the income scale. Now, I am an optimist in the sense that in response to a comment Jackie made earlier, I think the political system is capable of responding in a balanced way. And my evidence of that would be 1990 and 1993.

In both years, the political system produced a balanced deficit-reduction package. Both packages had progressive tax increases, health-care savings, other savings, both set roughly at \$500 billion over 5 years target for deficit reduction. And both were designed in a way to produce gross savings of more than \$500 billion, take the additional amount and plow it back into things like the two largest expansions of the earned income tax credit for low-income working families in history. The two largest expansions were part of those two deficit-reduction packages.

Those packages showed that it is possible in this country to reduce deficits and reduce poverty and inequality at the same time. Deficit reduction is not antithetical to moving a progressive agenda. And progressives should not be afraid to step up to the plate and help tackle this issue.

Let me close with two observations. One is I wish all of us, not just progressives, policymakers, the media, conservatives could get beyond the way we talk about taxes over here and spending over there. Often, the distinction is artificial. As we are going to hear from the tax panel later in this conference, the tax code is filled with what analysts call tax expenditures, spending in the tax code, what Alan Greenspan once called tax entitlements.

And on the spending side of the ledger, we have a variety of spending items that are not all that different in their function from tax loopholes. Think of some of the elements of farm price supports or look at what the current health-care debate is showing us about various unwarranted subsidies in the spending side of health care.

So bottom line, let's start digging into these issues. Let's not kick the can down the road. If we do kick the can down the road and a national or international crisis occurs that forces swift

and large deficit reduction action at a time when the political pendulum has changed sharply – think about what Charlie Cook just said – if that occurs, I really have a fear that many of the things that I and many of you have worked on throughout our lives, so that our fellow Americans can live better lives could be swept away and little of them could remain. And I think that is one of the reasons why this challenge is so important.

MS. CALMES: I think the political system has changed greatly since those '90 and '93 packages. But that is material for the next panel, I think, to address. But we have some time, the panel, to engage each other on things that each of you have said that you would like to address. And so I would like to make time for that. And I will probably truncate it a little to make some time for questions from the audience.

MS. TYSON: I just want to clarify one thing that I think ties together – I think each of us talked a little bit about interest rates. And Alan talked about inflation. I think it is important to put on the table that when we think about the concern about the deficit and government borrowing, we are thinking about the issue of the government crowding out private spending. The reason you worry about this is the government comes in. There is an upward pressure on real long-term interest rates that crowds out private-sector spending.

So a key question for everyone really – and that is what I was trying to raise in my comments is the extent to which an increase in savings in the U.S. in the household sector and the still availability of savings in the rest of the world because the rest of the world can't make up for the loss in U.S. demand. And there is a lot of unutilized capacity. We may have several years still of relatively low long-term interest rates, in which case the government deficit would not be crowding out private-sector spending.

So a lot of this is about what we think the savings and interest-rate future looks like. And sadly, when I – the reason I wanted to bring this up is I saw those interest payments that Bob put up there. That assumes an interest-rate trajectory, which is a pretty mild interest-rate trajectory. And you still have interest payments on the debt larger than both non-defense discretionary spending as a share of GDP and defense spending as a share of GDP. That is what those numbers look like, both of them.

So interest payments have become a huge thing even in a relatively benign interest-rate environment. If it turns out not to be benign, then the situation is that much worse.

MR. BLINDER: If I could just add, I learned a long time ago that one of the few things that is less accurate than economic forecasting is political forecasting. (Laughter.) But on the point that Bob finished with, I think kicking the can down the road is the overwhelmingly likely response of the American political system in the year 2009, '10.

As I indicated in my opening remarks, that is not such a bad thing if it ends in 2011. But I wouldn't bet on that either. And I think what is going to end it finally when it ends – I mean, the thrust of my remarks is this will end; this cannot continue – is the some people, some objects and, in particular, I am thinking about some financial markets are going to give the political

system a big swift kick in the pants, which will stop the kicking of the can. And that means a run-up in bond rates.

Now, if you tried to convince the body politic or their elected representatives in Congress that we have a deficit crisis when the 10-year bond rate is 3.3 percent, you could talk until you are blue in the face and you are not going to do it. I think what finally enabled us in 1993 and in 1990 – so it was us in '93, it was them, so to speak, in 1990 – were ructions in the bond market or fears of worse ructions in the bond market. And I think until the bond market vigilantes form a posse – (chuckles) – again, which they haven't in a very, very long time, it is just too easy to ignore this issue.

MS. CALMES: I am told – Bob, did you want to address any of this?

MR. GREENSTEIN: Well, I think the only comment I wanted to make in response to yours. Of course, I agree that there have been very major changes in the political system since '90 and '93. When our center first started – I am going back into the early '80s now. It sometimes surprises people to hear that the single member of Congress we worked most closely with in our first year was Bob Dole. There really aren't Bob Doles left at least that I can see in the Congress these days.

But the comment that I made, I often find people who start by assuming that our political system has never produced the kinds of tough choices and deficit reduction in a balanced way that it did do in '90 and '93. And while the political system has changed, the fact that it was able to produce those in that era, to me, gives some hope. Although it raises the question, which is way beyond the scope of this panel, as to how do we get back to the kinds of political contexts and political contours that existed at that period that enable the political system to produce that action at that time? And that is another long discussion. And I am probably not the right person to answer that question.

MS. CALMES: And in fairness to the system, it did produce TARP on a second try in the House last fall. But that, again, was with a divided government. And it had the –

MS. TYSON: That is another group of vigilantes.

MR. BLINDER: It had a big kick in the pants.

MS. TYSON: Yeah, those are the vigilantes.

MS. CALMES: And even with that, it took two tries in the House with a president of the Republicans own party in power. I think we have – we have some time left for questions? Okay. There should be microphones floating around somewhere. Does anyone want to take the first question? There you go. Out here there is a man in the middle of the audience. And could you please identify yourself?

Q: Sure. My name is Michal Baranowski from the German Marshall Fund of the United States. I actually wanted to ask you about foreign policy consequences of the national debt.

Going beyond – I mean, you mentioned defense spending. But I wanted to ask you sort of a bigger impact on the power that U.S. will have in the international system given the projections that you showed us. Thank you.

MS. CALMES: Do you want to take that, Laura?

MS. TYSON: I will start. I think that look; we are in a process, which was ongoing anyway. I think the events of the last year have accelerated that process. It is a shift in income, wealth and relatively economic power therefore, to the emerging market countries and particularly to the emerging market countries of Asia.

It is true that China has a dollar problem. And Paul Krugman has written quite a lot about that. He is sitting over there. But at the same time, its dollar problem means that it can and will and continues to do so verbally try to exercise pressure on the U.S., certainly on economic policy.

I mentioned that I was pleased by the G-20 in the sense that, you know, that announcement of how countries would look at one another's plans really apparently came out of the U.S.-China dialogue. And basically, right now China is taking action to adjust its policies to shift to more domestic demand. And the U.S. is talking about adjusting its policies to take more control of its foreign borrowing needs.

So on the economic front, I think, you know, we have less relatively economic power and we will have as when you have creditors, they will try to influence you. And I do think over time, we are going to move to more of a multi-reserve currency world. But that is a long-term issue.

I will leave to foreign policy experts thinking more about the implication in other kinds of foreign policy. What I will say is just think about those numbers. We will be spending more on interest on the debt as a share of GDP than on defense. We have not talked seriously here at all today – talking about 2050 and 2080 – and haven't mentioned climate change or the environment. There are many people who feel, you know, to imagine a world of 2050 or 2080 now and say that the main thing we are worried about is the deficit and the debt when we have a planet, which is facing very, very severe disruption. That is a major foreign policy issue. It is a major security issue.

I am not clear that the U.S. yet has a grip on that. And that investment spending up there, that everything else category would include everything else the U.S. might try to do from a research point of view, an infrastructure point of view, et cetera, et cetera. So this really constrains our ability to act in other key areas, including foreign policy.

MR. BLINDER: I would just like to make two brief points in answering that question. First of all, when the time comes to be serious about reducing the budget deficit, one thing we know and it has been true a very long time is that foreign assistance has been the least popular, politically popular piece of the U.S. budgetary expenditures for a very long time. I guess the

good news there is it is so little that you can't cut it very much. But it will come under further pressure.

The bigger point I want to make and it echoes something Laura was just alluding to is I think we are running a very interesting geopolitical experiment now, which is for how long can the biggest debtor supplicant nation in the world be the biggest world economic political and everything else you can think of power? It has lasted a while now. My guess – but I really want to underline guess – is that it will last a good while longer and that we are going to find out the answer to this is quite a long time.

Here is the hazard. Should it ever be the case that China gets really, really angry with us over some non-economic or maybe even economic – but I tend to think more non-economic issue that gets people really fired up. I don't know what that issue might be and this is not a forecast. But should they ever get so angry that despite the fact that killing the dollar will hurt them more than it hurts us, they decide we are going to do it anyway. We are not going to send missiles over to the United States. We are going to start selling dollars even though it will hurt us. We are in a vulnerable position for that. I don't see this happening anytime soon, but I think it is a risk that sort of lurks in the background that is germane to your world power issue.

MS. CALMES: There was a question over on this side. Man to the left – well, my left with the blue shirt, I think. It is hard to see.

Q: Bernard Wasow, the Century Foundation. There was considerable discussion of the reforms of 1990 and 1993. There was no mention of 1986. And I wonder why that is. That was a time when tax expenditures were reformed. It was a time when taxes were raised in the context of a large reform. And it seems to have had much less serious political consequences, certainly than the 1990, perhaps the 1993.

And it seems to me that if we need to raise taxes significantly within the context of a major reform like that, we could not only reduce tax expenditures, we could introduce VAT, say, at 5 percent, collecting, say, something like three-and-a-half percent of GDP, if it were a flat tax. We could make the income tax more progressive. We could do a lot of good things. So why was 1986 not mentioned?

MS. CALMES: Well, I think this panel was about looking ahead and the consequences for the economy. And this next panel will look at this. But Bob?

MR. GREENSTEIN: Well, as the person who principally mentioned '90 and '93, the reason I didn't mention '86 was that the Tax Reform Act, which I think was a terrific piece of legislation, the Tax Reform Act of '86. But it was deficit neutral. It wasn't deficit reduction.

Where I think the question is directly relevant to the matter at hand, though, is that I do think one of the things we ought to be thinking about is tax reform that has some of the kinds of features of '86, particularly base broadening, but unlike '86, is not deficit neutral because in the current context, I think that the next tax reform needs to have a net effect of raising some revenues, especially for the long term rather than as in '86, being strictly deficit neutral.

MS. CALMES: Bob, I am going to take prerogative to recognize Bob Rubin.

Q: Bob Rubin, Council on Foreign Relations. Laura, you and a little less, I guess, Bob, talked about the risk and really in terms of crowding out, whereas I would have thought the risk that would be more on people's mind is that markets can change psychology very unpredictably and very rapidly and dramatically and that when they do, you can have very severe effects. And it seems to me that is the far more troubling aspect of where we are and argues much more – although I agree with you, you don't want to deal with this during a period where our economy is so weak. But doing something now that signals that we are going to deal with it and then having real serious purpose once we can deal with it.

So the question is why we haven't had more of that kind of – if you were in New York and having the same conversation with people in the investment world or if you were in China, which I am going to next week, I think that is much more the tone of the concern that you would hear. And then you would hear somebody mention something like you and Alan both did about pre-committing. And I would remind you that in 1993, we won by one very reluctant vote in the House and we had a tie in the Senate, not exactly a dramatic rallying around with respect to fiscal discipline. So what would make you think that our political system is likely to respond more effectively today?

MS. TYSON: Look, I ended my – I probably wasn't entirely clear the way I ended my comment. I agree with you. I think that financial markets are unpredictable. I think that we were living in a world where we had huge imbalances, growing imbalances, savings glut for 5 years. And people kept predicting that there would be a break. And the breaks they predicted were either – well, there was a kind of spike in long-term interest rates and a decline in the value of the dollar – precipitous decline in the value of the dollar or maybe a trade war. And, in fact, neither of those occurred, okay. What happened was something entirely unexpected.

Now, we still have – but in that unexpected dénouement, we have not gone away from a couple of things. We still have very low, abnormally low, historically low real long-term interest rates. We still have an increasingly right now, not decreasing, but perhaps increasing global savings availability because U.S. households are saving. We have the Chinese talking about their dollar problem and continuing to accumulate dollars and buying – they are diversifying into equities, but their dollar equities are not diversifying into non-dollars.

So I agree that this is all not a, sort of, sustainable long-term equilibrium. But it is very hard to predict when and how this disruption will occur. So what I would say is we all agree. This system has a huge risk of another significant disruption. We don't exactly know the form it would take. We don't know exactly when it will occur. I think the challenge is if we could pre-commit, we would basically be sending a message, which would come take away some of this risk. And then we wouldn't have to do something – you see, we have two risks. If we do something very precipitous and fast, I think we really undermine the recovery, which I think is a very weak recovery. So we don't want to do that.

But if we don't do anything to sort of get at the growing concerns that the U.S. is out of control, then I think we are building that other risk. So we are balancing these two risks. I think we absolutely agree on this.

MR. BLINDER: If I could just add, that is what I was thinking about when I talked about the bond market vigilantes. And on timing, I don't know when that happens. It is not going to happen as long as so much of the world's money is still scared and looking for a safe haven because we know where they find the safe haven.

On the pre-commitment, Bob, you asked what makes us think that Congress will do something like that. I don't think Congress will do a thing like that. But that doesn't stop professors like me from saying what they think Congress should do. (Laughter.)

MR. GREENSTEIN: I wanted to just make a quick comment on Bob's final comment about the political system. So let me for a second go back and dig a little further into the '90 and '93 experience. So I think one of the issues is that there is a view, particularly among lots of Republicans, that George H.W. Bush agreed to a bipartisan deal that included revenue increases in '90. And he lost in '92. And that Democrats, as you mentioned, put through a deficit-reduction package in '93, and they lost the Congress in '94. And I would argue the greatly oversimplified message is tough hard choices on deficit reduction and you lose the next election.

Now, in reality, I think George H.W. Bush lost largely on other issues in '92. And in '94, Charlie Cook may tell me or John Podesta may tell me I am wrong, I think the crime bill probably had a bigger impact on the outcome of the congressional elections than did the 15 months earlier passage of the 1993 Budget Reconciliation Act.

Where does this lead you? Where I think it leads you is that maybe what we need is some first modest step on deficit reduction to somehow actually get enacted where the people who have the guts to vote for it don't lose the next election to begin to change the political calculus here from one of total fear. Because unless we get beyond this assumption of make a hard choice and you die in the next election, it is going to be hard to make progress.

MS. CALMES: This reminds me of on the plane covering the Bush campaign in the year 2000, then-governor Bush would come back and talk to the press frequently at the end of the night just for a few minutes off the record. And many times he would drop the line that sort of defensively that history is going to consider my father a good president. And, you know, we would just listen. We didn't really follow up. But one night, I had had a beer, so it was dangerous – (laughter) – and he said it again.

And as he walked back to his cabin, I said, you know, governor, you have said this a number of times to us through the course of the campaign. And it is really not my place to say, but I really – I think you are right. I think history will see him as a better president than was shown at the time. But I said I bet we would differ about the reasons. And I ticked off about four or five bills like the Americans with Disability Act, ending the war in Central America.

And I said, but most of all, the 1990 Budget Act. And he just looked at me and said, interesting. (Laughter.)

MR. BLINDER: You didn't take it to heart.

MS. TYSON: Yeah, you didn't take it to heart.

MS. CALMES: We have time for one more question over here.

Q: Frank Raines, formerly of OMB. Everyone is picking their favorite deficit-reduction effort. Mine happens to be 1997, when we actually did balance the budget. And I raise two points. One, if this were any other country, would anyone believe that we would actually pay the interest at that level on the debt at the numbers we are talking about? If this was Brazil or some other country, we would all be assuming that would not happen and that that debt would be repudiated in some way.

How long can we show these kinds of projections and not cause others to at least raise the question in their mind, is an American Congress really going to vote to pay most of its taxes to foreigners in order to pay off a debt that was incurred long before for reasons that the then-existing politicians don't agree with?

The other point that I would make – and this is to tie Charlie Cook's point in in great anger, I think the more likely scenario given what Charlie was saying is going to look more like 1997 than looks like the earlier periods, where balancing the budget became a political imperative for Republicans and Democrats not because of virtue, but because of the prior election, where a third-party candidate ran on the platform – and didn't win, didn't have a chance of winning – but did more than enough to determine the election.

The battleground was amongst the quote, "crazies," as Cook said. It seems to me it is highly likely we are about to see that happen again. And either that energy is going to be captured by another third-party effort, which will have a huge impact on who wins between Republicans and Democrats or one of the parties, Republicans or Democrats, will leap out ahead of that, capture that anger. And the greatest expression of it, I think, comes down to budget politics because it comes down to revenue; it comes down to overall government spending.

But I just raised those two issues as to the perception of the United States' willingness to stand behind this. We used to call – when I worked on state and local governments, are you going to pay the cops or pay the bondholders? And this second question about the anger having a political impact on the two parties being captured around issues related to budgets.

MS. CALMES: Anybody want to respond to that?

MR. BLINDER: If I could rise to the more economic challenge. I will skip the political issue that you raised, Frank. But in terms of debt repudiation, I just don't think that unless things get much, much worse than almost anyone is expecting, the thought that the United States would repudiate its debt will enter any serious minds. And I mean that in two contexts.

One is explicit repudiation, which I think is mostly what you were talking about. I mean, Alexander Hamilton set us on the right track on that a very long time ago. We have never deviated. And I think everybody in the country thinks Alexander Hamilton was right. So I just don't – I just don't – that is not within my set of possible eventualities.

The more likely form of repudiation if there is any – and we did some of this in the 1970s, though I would argue by accident, is you repudiate by inflation. Those people that are now lending us – lending the U.S. Treasury 10-year money at 3.3 percent will have a big shock if the inflation rate averages 6 percent over the last 10 years. And we will effectively have repudiated a fraction of that debt.

To get that to happen, the Federal Reserve has got to be complicit with Congress. So anyone who wants that to happen – I am sure you are not one, Frank, obviously. Anyone who wants that to happen should start growling and making menacing gestures about the independence of the Fed and getting the Fed under congressional control. But I don't think that movement is going to go very far in this country or maybe I should say I sure hope it doesn't. (Laughter.)

MS. CALMES: Well, it is time for the next panel. And some of the questions I know that were still out there I think will fold over into the next panel because it is a good segue here to move to the panel that is going to talk about sort of how to fix it. (Applause.)

(END)