



The Big Questions

Setting the Stage for Fiscal Reform for the New Deficit Commission

By John Podesta and Michael Ettlinger | April 26, 2010

President Barack Obama's bipartisan National Commission on Fiscal Responsibility and Reform meets for the first time tomorrow, its 18 members tasked with addressing the knotty issue of the federal government's middle- and long-term budget deficits. The immediate premise for the commission is an accounting problem: how to make the government's books start to add up. But what is truly at stake is the economic prosperity and security of our nation and its people, as well as the quality and breadth of important public services on which we all rely.

Our country's success in achieving our national goals is, in no small measure, determined by how we spend and tax—by key investments ranging from national defense to higher education, from scientific research to retirement security. In the end, the exercise the commission is undertaking is as much about the opportunities and security that America offers all of us as it is about dollars and cents.

As an accounting problem the commission's task is substantial. Even after we get past the current very large deficits caused by the fiscal policies of the 2000s and magnified since 2007 by the Great Recession, the total federal budget deficit is currently projected to top \$1 trillion in 2018 and never get any lower. That means sustained deficits at the unsustainable level of over 5 percent of our national gross domestic product. It means the government's publicly held debt obligations will top 90 percent of GDP by the end of the decade—the highest level as a share of the economy since 1948.

The presidential order creating the new commission divides the problem into one very specific instruction to the commissioners and one less specific one. The more specific charge is to propose recommendations that by 2015 would bring the federal budget to primary balance, which means that total tax revenues must match total spending except for interest payments on the national debt. Congressional Budget Office analyses suggest this would require closing a 2015 budget gap of about \$250 billion. Beyond 2015, the commission has a less specific goal: to “propose recommendations that meaningfully improve the long-run fiscal outlook.”

The ultimate test for the commission will, however, be whether it can make the tax and spending numbers add up in a way that best serves our country's future while garnering the support of the commission's diverse membership. To achieve this, we believe the core questions for the commission can be distilled to six:

- How do we make government more efficient and productive to achieve savings and better serve the American public?
- How do we spur economic growth?
- How can we bring the defense budget into alignment with fiscal realities while meeting our 21st century national security needs?
- How can we achieve critical savings in the health care arena?
- Can changes to Social Security be a part of the solution?
- Can we increase tax revenues?

Let's address each of these in turn.

How do we make government more efficient and productive to achieve savings and better serve the American public?

The first step in addressing our fiscal problems must be to ensure we are getting our money's worth for every dollar spent by the federal government. If we can improve government productivity, then we will make important progress toward the commission's fiscal goals while improving the quality of our public investments and services and increasing the public's confidence in its government. There are three parts to making the federal government work better.

First, government programs that are ineffective or duplicative should be eliminated or consolidated. The government should be doing what works and getting rid of what doesn't. The commission should step up and identify specific cuts, combing every corner of the budget from the Department of Defense to the Department of Education, from agricultural subsidies to the huge range of subsidies administered through the tax system. The commission should also recommend changes in government processes so that, going forward, ineffective or duplicative programs aren't adopted in the first place or are quickly recognized and eliminated.

Second, managers in government agencies should have 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 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.

Together, these three steps would ensure that the absolutely necessary things federal government does—from the large government programs discussed below to the relatively small amounts spent on federal services for low-income families and vulnerable children, air traffic control, consumer protection, law enforcement, and myriad other programs—are done well. In an era of scarcity, to have successful programs address our national needs requires that each dollar is spent efficiently and effectively—both to make our tax dollars go farther and to ensure that there is public support for necessarily public solutions to public problems.

How do we spur economic growth?

The best way bring down budget deficits is through a growing economy that naturally generates more tax revenue, reduces the strain on government safety net programs, and enables the government to more affordably service our national debt.

Slashing government spending in ways that hurts economic growth would be decidedly unhelpful. Conversely, public investments that catalyze growth in the private sector can help the fiscal outlook greatly. Key public policies that can underpin private innovation, investment, and competitiveness, and thus economic growth, include:

- Improving education
- Public investments in basic scientific research
- Jumpstarting new technologies in low carbon energy and health
- Ensuring availability of credit
- A fair, responsible tax system for individuals and corporations

We cannot afford to do everything we might like, but, in making tough decisions, the commission's proposals need to be constructed with an eye on medium- to long-term economic growth as much as on medium- to long-term fiscal deficit reduction. Without the former it will be impossible to have the latter.

How can we bring the defense budget into alignment with fiscal realities while meeting our 21st century national security needs?

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 almost as much on defense as every other country in the world combined. In 2015 spending on defense and other “security” activities will take up close to 20 percent of the federal budget.

And, of course, if the projected savings from the end of the two current wars we are fighting don’t materialize, or another war we cannot now foresee becomes necessary, then the budget deficit will be worse than anticipated. The upshot: The commission must address defense spending. Just some selected examples of acquisition savings include:

- Producing only one Virginia-class attack submarine per year instead of two, saving \$2 billion
- Cutting the purchase of F-35 joint strike fighters in half, saving \$4 billion
- Keeping missile defense systems in the research phase and delaying deployment until they work, saving \$6 billion

The commission should also examine 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.

Finally, the commission should consider 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, expected to be close to \$700 billion in 2015, 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.

How can we achieve critical savings in the health care arena?

Recently enacted health reform legislation contained a number of measures to reform the health care payment system to ensure greater efficiency while improving the quality of care. These reforms include:

- The bundling of payments to doctors for episodes of care, not the number of visits to doctors
- Accountable care organizations that reward health care providers for their quality of care
- Primary care medical homes to ensure effective preventative care
- An independent payment advisory board to ensure the government gets what it pays for in Medicare and Medicaid

These innovations are all designed to change the incentives in the health care system toward rewarding quality over use and prevention over expensive care. Conservatives allege there will be no savings associated with these steps, and CBO assigned minimal savings to these reforms in part because there is not sufficient track record around them. Yet many health care experts argue that such steps can have dramatic savings.

Harvard University Health Economist and CAP Senior Fellow David Cutler, for example, contends there are \$600 billion in savings to be found over the long term through reforms like these. Indeed, health care experts from across the political spectrum believe these initiatives hold significant promise for large-scale savings over the long term by moving a health care system plagued by fragmentation and overuse toward a more integrated, efficient system, with savings to the public and private sectors.

The potential for greater efficiency through payment reform across the whole health care system stands in sharp contrast with cost containment approaches that would limit spending by limiting public benefits. Such a misguided approach only shifts costs. It does not contain them. The key challenge, then, is to ensure that the Obama administration takes sufficiently aggressive action to realize the potential of these savings.

That's why we suggest that as the administration moves to implementation, the commission should support steps to test, evaluate, and effectively adopt aggressive efforts around payment reform, and to promote partnership with the private sector to assure system-wide change in payment structures and incentives. Furthermore, as the recently enacted legislation moves forward in implementation, we will learn a great deal about the effectiveness of new methods of payment. As a result, we will be able to take additional steps in the legislative process.

The commission may want to identify additional action, such as triggers for reductions in expenditures, if health savings are not achieved to ensure more public and private sector savings as we learn from the initial steps of the legislation.

Can changes to Social Security be a part of the solution?

There is a projected long-term imbalance in Social Security that, while not a main driver of long-term federal deficits, will contribute to them and will eventually put benefit levels at risk. With private sector pensions becoming weaker, a strong Social Security system is especially important to economic security.

The commission has an opportunity to address the long-term imbalance and also strengthen the system for beneficiaries by putting in place a minimum benefit to ensure that no elderly person who has worked most of their life lives in poverty. Any reasonable reforms will have virtually no impact on the 2015 fiscal picture and a relatively modest effect on longer-term projections. But reforms could starkly demonstrate to skeptical debt markets that the United States is willing to take on a politically difficult fiscal issue—a demonstration that could put the United States in good stead with investors around the world.

Can we increase tax revenue?

Revenue increases will have to be part of any serious commission proposal. Doing it all through spending cuts is simply not realistic 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 several other programs, the level of cuts needed in the rest of government to close the \$250 billion 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 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. 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 two major tax-cutting eras of Presidents George W. Bush and Ronald Reagan. Average annual GDP growth after the 1993 tax increases was 3.9 percent, but after the Bush tax cuts 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 Bush era tax cuts.

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, as detailed in the 2008 CAP report “[Take a Walk on the Supply Side](#).” Additional revenues can and must be part of the solution, as they have been in the past.

Conclusion

These six central questions will largely govern the work of a successful commission and also the work of our nation as we try to reconcile our national priorities with our fiscal challenges. There is, however, a broader question for which the commission may also provide an answer: Can leaders of good will come together and reach across the divides between them to have honest discussions about our national challenges?

As the questions and commentary above suggest, there is simply no way to achieve the fiscal objective that we largely share without raising revenue and making hard choices on spending. That’s not something anyone wants to do, and there is much political hay to be made by digging heels in and playing tough. But it is precisely that short-term political instinct that stands in the way of achieving our shared medium- and long-term objectives. The commission will be a good test as to whether political leaders can get past such gamesmanship for the good of their country.

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