"Moving to a Fiscally Sustainable Budget"

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Senate Budget Committee

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Chairman Conrad, Ranking Member Gregg, and Members of the Committee:

I greatly admire this Committee for your persistent efforts to focus the attention of the Congress and the nation on the dangers of projected increases in the public debt and the importance of moving the budget onto a sustainable trajectory. It is a shame that the bill establishing the Conrad-Gregg Task Force did not pass and that the President's announcement of a Debt Reduction Commission has not received strong bipartisan support. But those of us who care deeply about this issue must not give up! Hence, I appreciate the opportunity to participate in this hearing and hope to reinforce the Committee's commitment to keep pressing for solutions to the most serious threat to America's economic security and leadership capacity.

The dangerous trajectory

On any reasonable set of economic assumptions, the U.S. budget is on an unsustainable track. There is no disagreement among the Office of Management and Budget (OMB), The Congressional Budget Office (CBO), The Government Accountability Office (GAO), and leading private forecasters on where the budget is headed if we do not change course. In the next decade and beyond, federal spending, driven by the impact of an aging population and rising health care costs on Medicare, Medicaid, and Social Security, will rise substantially faster than the whole economy can grow—faster than the GDP. Revenues, at any likely set of tax rates, will grow only slightly faster than the GDP. The gap between spending and revenues will keep widening. The growing deficit will be more and more difficult and expensive to finance. Ultimately, we will not be able to borrow enough to finance the widening gap between spending and revenues.

These projections are not new--they predate the financial crisis and the current recession. But two or three years ago, deficits, while inappropriate in a prosperous economy, were of manageable size. The deficit in FY2008, for example was 3.2 percent of GDP and debt held by the public at the end of that year was 40.2 percent of GDP--not especially high proportions by either historical or world standards. The warnings of this Committee and others about bigger deficits looming in the future were not gaining traction with a complacent public.

But the financial crisis of 2007-8 and the deep recession it precipitated changed the budget outlook dramatically. Revenues fell rapidly as the recession spiraled downward. Spending exploded as emergency measures were taken to keep the financial sector from melting down and to mitigate the effects of the recession. The deficit peaked at more than 10 percent of GDP and the debt soared to an estimated 64 percent of GDP this fiscal year. Deficits will recede as the economy recovers and temporary spending measures expire. However, deficits are not projected to return to previous levels and debt will keep growing rising faster that the GDP even as the economy returns to normal growth. Moreover, the double impact of aging and medical spending—once seen as a "long run" problem—is already driving deficits and debt higher and will accelerate by the end of the decade. Complacency about the fiscal threat is no longer possible. Unfortunately, complacency has been replaced by strident partisan blaming--not yet by a willingness to cooperate on crafting solutions.

But solutions must be found—and soon. As our debt mounts, the risk grows that our creditors, especially the foreign creditors who own half our debt, will lose confidence in our ability to get our house in order and will demand dramatically higher interest rates to lend us more. Rapidly rising rates would derail the economic recovery and balloon the cost of servicing the federal debt. Escalation of the debt has made near term action to reduce deficits more urgent than it would have been at lower debt levels. We no longer have the luxury of waiting for several years until we are sure the economy is growing strongly before taking action to stabilize the debt. We have to take action very soon to arrest the debt build-up before it threatens the confidence of our creditors. Moreover, while there are persuasive economic reasons for curbing the increase in our debt, the moral case is even stronger. It is unconscionable for today's Americans to live persistently beyond our means and pass our bills on to future taxpayers.

Stabilizing the debt increase—at what level and when?

Rapid near-term deficit reduction would derail the recovery and risk sending the economy into a second downturn. But adopting a firm debt reduction goal and a credible plan for achieving it over a defined period would likely increase the chances of sustained recovery. A goal-oriented plan would reassure our creditors that we understand the problem and are taking action. It would reduce the risk of rising interest rates.

Two high level groups, including both Republican and Democratic budget experts, have recently recommended stabilizing the debt at 60 percent of GDP by a date certain. There is nothing magic about 60 percent, but the goal has been approved by both the European Union and the International Monetary Fund and is not so stringent as to be unachievable. A crucial question is 60 percent of GDP by when? The Peterson-Pew Commission on Budget Reform, of which I was a member, recommended stabilizing the debt at 60 percent of GDP by 2018, with actions starting in 2012 (*Red Ink Rising; A Call to Action to Stem the Mounting Federal Debt,* December 2009*).* Given the depth of the recession that goal is quite ambitious. The Committee on the Fiscal Future of the United States also recommended the 60 percent goal, but proposed getting there more gradually over the ten-year period, 2012-2022 (National Research Council and National Academy of Public Administration, *Choosing the Nation's Fiscal Future, 2010)*. Even this more gradual trajectory would require substantial changes in current budget policy. Stabilizing the debt to GDP ratio, and eventually bringing it down, however, would not actually require a balanced budget in a growing economy. It would only require that deficits not add to the debt faster than the growth of GDP.

Pre-requisites of a credible plan

I believe that a credible, politically viable plan to stabilize the debt must have two characteristics:

- It must include both reductions in projected spending and revenue increases; and
- It must have support of the leadership of both political parties.

The widening gap between projected spending and projected revenues is too large to be closed by either spending cuts or revenue increases alone. The rapid projected growth in spending is driven by commitments to an aging population, especially for medical care, that are pushing up federal spending faster than GDP can grow. Reducing that spending growth to rates more in line with GDP growth is imperative and can be achieved only by greatly improving the efficiency of our health care delivery system, paring back lower priority entitlement benefits and holding the line on discretionary spending. But given the rapid aging of the population, especially in the near-term, the high demand for medical care, and other necessary and widely supported functions of government, it is unrealistic to bring the growth of spending into line with GDP growth in the next decade.

In addition, our tax system is extremely inefficient and complex. Part of the gap should be closed by reforming the federal tax system so that it produces more revenue with less drag on economic growth.

Partisanship has grown more extreme in the last few years and is at an especially high pitch in this election year. Neither party wants to take the lead in proposing unpopular policies such as cutting the growth of entitlements or increasing revenues, and each is eager to blame the other. But putting the budget on a sustainable track requires these unpopular actions, and the only way to accomplish them is for both parties to work together. I have never been a fan of commissions—it would be much better if Congress could stabilize the debt by using its regular budget process—but a bipartisan commission with fast track authority is the best hope for serious debt reduction right now. I hope there will be an opportunity for the Congress to reconsider its rejection of the Conrad Gregg proposal or something like it or to embrace the President's alternative and give it the force of law.

Meanwhile, former Senator Pete Domenici and I have recently launched a Bipartisan Debt Reduction Task Force that we hope will demonstrate that Republicans and Democrats can work together to produce a sensible, viable debt reduction plan. Under the auspices of the Bipartisan Policy Center, founded by former Senator Leaders Dole, Daschle, Baker and Mitchell, we have launched an effort that we profoundly hope will show that crafting a bipartisan debt reduction plan is not an impossible task. We have recruited an impressive group of citizens, former elected officials, and budget experts to help us (list attached) and will report by the end of the year. We hope to support the efforts of an official Commission, whether statutory or created by executive order, and in any case to make our recommendations available to the public to foster discussion and debate. We will be happy to assist this Committee in any way we can.

Thank you.

BIPARTISAN POLICY CENTER

DEBT REDUCTION TASK FORCE
(Membership as of February 4, 2010)

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  United States Senator from New Mexico (1973-2009)
  Former Chairman, Senate Budget Committee

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