Statement of Robert D. Reischauer [*]
to the
National Commission on Fiscal Responsibility and Reform
April 27, 2010

Co-chairmen Bowles and Simpson and members of the Commission, I appreciate this opportunity to discuss the challenges this Commission faces as it crafts a package of specific measures that will meet the medium- and long-term goals laid out in the President's Executive Order of February 18, 2010. I do not have to tell you how daunting your task is, nor explain to you the risks our nation faces if we do not begin to put the federal budget on a sustainable path.

Recently the public has shown increasing concern over large deficits and the growth of federal debt. But it is clear that few Americans fully understand the seriousness of the problem, the consequences of inaction, or the degree of sacrifice required to ensure that our children and grandchildren enjoy, as we have, an economy that provides rising incomes and expanded opportunities. Thus, the Commission's first task should be to make a clear and convincing case that:

- Significant adjustments in our current spending and tax policies are unavoidable.

- If we do not begin these adjustments soon, our economy's vitality will gradually be sapped, our ability to chart our own course in this increasingly unstable world will erode, our government's capacity to meet crises and address emerging priorities will be constrained, and our dependence on foreign creditors and their influence on our policies will grow. The longer we delay, the greater the risk of catastrophic economic consequences.

- The magnitude of the required adjustments is so large that spending cuts will have to affect programs we all care about and benefit from and revenue increases will have to come from a wide swath of Americans. In other words, raising taxes on the rich or corporations, closing tax loopholes, eliminating wasteful or low-priority programs, and prohibiting earmarks simply won't be enough.

- And, finally, the sooner we start addressing the problem the less wrenching the adjustments will have to be and the more control we—as opposed to market forces, foreign creditors or, in the extreme scenario, international agencies such as the IMF—will have over the timing, size and composition of these unavoidable adjustments.

***** President of the Urban Institute. The views expressed in this statement should not be attributed to the Urban Institute, its sponsors, staff, or trustees.

Having analyzed federal budget issues over the last four decades and participated in several efforts to reduce the deficit, let me offer four pieces of advice.

- First, don't waste time looking for silver bullets or new approaches that hold out the promise of painless sacrifice. There are none to be found. The Congressional Budget Office, the Government Accountability Office, past presidential budgets, and think tanks, university researchers and interest groups have put forward hundreds of proposals for moderating spending growth and enhancing revenues. Use these, selecting the specific measures that, when combined into a single package, best meet the nation's economic, social and political needs.

- Second, don't take any category of spending, specific program or revenue option off the table until you have finished crafting a complete proposal. A particular option that may look very unappealing at the start of your deliberations could turn out to be a critical piece of the puzzle before you are done. Our past experience suggests that successful deficit reduction efforts are balanced and extract sacrifice from all of the major budgetary "food groups"—taxes, fees and charges, entitlements and discretionary spending.

- Third, don't assume that budget process reforms—that is new procedures for making decisions about spending and revenues—can substitute for or create political will. The solution to our fiscal problems will not be found in a balanced budget amendment to the Constitution, line item veto or beefed up rescission authority for the President, a joint rather than concurrent budget resolution, biennial budgets, discretionary spending caps or strengthened PAYGO rules. History has shown that if lawmakers do not want to rein in spending or raise taxes to curb deficits, no procedural reforms can make them do it. Congress and presidents have had no qualms about eviscerating or evading procedural requirements that have proven too politically costly. At most, such reforms can stiffen the backbones of lawmakers so they stay a course that has already been enacted or provide some modest political protection to those who are already committed to deficit reduction.

- Fourth, stay focused on the ultimate objective of the effort—ensuring the healthy growth, competitiveness and stability of the nation's economy over the long run. This implies that spending programs and provisions of the tax code that rigorous, objective analyses have shown contribute significantly to the economy's long-run growth potential should, if possible, not be scaled back. Of course, this is easier said than done because many programs and tax breaks claim, without hard evidence of their comparative effectiveness, to be growth promoting. But many programs that do enhance economic growth could be restructured in ways that would deliver more bang for the buck.

Let me conclude with some observations about tax burdens, entitlements, health care costs and the appropriate long-run fiscal goal.

Many observers have pointed out that revenues have averaged roughly 18 percent of GDP over the post WW II period. From this they deduce a natural law of American budgeting and assume that, going forward, revenues should be held close to 18 percent of GDP and spending should be constrained to no more than a couple of percentage points higher. That combination would achieve sustainability, that is, keep the debt to GDP ratio from rising. But since the mid 1970s, keeping revenues around the 18 percent of GDP level clearly has not been enough to keep our debt from growing faster than our economy. Looking forward, it is unlikely that spending can be held to 20 percent to 21 percent of GDP unless we are willing to fundamentally rethink the entitlement commitments the federal government assumed in the mid 1930s, the mid 1960s and in 2010, or to downsize significantly our defense capabilities, or to eliminate virtually all of the of the federal government's traditional non-defense activities. In short, to achieve fiscal sustainability we are going to have to accept higher tax burdens than we have enjoyed in the past. The challenge will be to adopt those revenue enhancing measures that are most compatible with economic growth and equity.

Getting on a sustainable budget path over the long run will also require measures to moderate the growth of entitlement spending, but such measures are unlikely to contribute significantly to reduced deficits during the next five or even ten years. Because most entitlement spending goes to retirees and vulnerable individuals who have limited ability to either absorb benefit reductions or compensate for any cuts by working more, changes in benefits must be phased in gradually over many years. While there may be some short-run scope for reducing the implicit subsidies enjoyed by upper income elderly, the amount of deficit reduction that might be garnered this way over the next decade is quite modest.

Most of the fiscal imbalance projected for the future derives from the expectation that health care expenditures will continue to rise more rapidly than the rate at which the economy will grow. It is thus natural to look at ways to curb the growth of federal health care spending which is concentrated overwhelmingly in the Medicare and Medicaid programs. However, this will be very difficult to do over the next decade for three reasons. First, under the Patient Protection and Affordable Care Act (PPACA), Medicaid costs will rise significantly because the program plays the primary role in expanding coverage among low-income populations. While a recent report from UnitedHealth concludes that significant savings are possible in the program, realizing them would require adopting effective coordinated care for Medicaid's regular population and community-base/coordinated care for Medicaid's long term care beneficiaries.[1] Effective coordinated care is unpopular and difficult to do well.

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1 UnitedHealth, Center for Health Reform and Modernization, *Coverage for Consumer, Savings for States: Options for Modernizing Medicaid*, April 2010.

Second, under the PPACA Medicare spending has already been reduced significantly, so much so that the Chief Actuary of Medicare has warned that beneficiaries may face access problems in the future if the required reductions in payment updates are adhered to.[2] While the health reform act contains many promising demonstrations and pilot projects designed to test incentives and organizational changes that might slow spending growth, it will be more than five years before the results from these experiments can inform policy.

Third, the growth rate of the costs of the government's health programs can not be reduced for any significant period below that of private sector without creating access problems, inferior care for beneficiaries or burdensome cost shifting onto the private sector. For this reason system-wide reforms and incentives are the only way to rein in the growth of Medicare and Medicaid costs over the long run. It will take time before we know which measures can be effective at holding down system-wide cost growth.

Finally, while the medium-term mission spelled out in the President's Executive Order—propose recommendations that balance the primary budget by 2015—is specific, the long-run mission—achieve fiscal sustainability—is less clear. Some may argue that you should strive to balance the unified budget by some date certain. Others will say, as several independent groups have recently recommended, that the goal should be to stabilize the debt to GDP ratio at some specific level like 60 percent or 70 percent.[3] There is no need to strive for a balanced unified budget. Modest deficits are consistent with a gradual reduction in the debt to GDP ratio—this is what happened between 1946 and 1974 when deficits averaged 0.6 percent of GDP and the debt to GDP ratio fell from 109 percent to 24 percent.

Stabilizing the debt to GDP ratio is an appropriate goal but whether the target is 60 percent, 70 percent or even 90 percent is less important than enacting a credible package of policies that can achieve the goal. Everything else equal, a lower debt-to-GDP ratio is better than a higher figure. But setting a target that is too ambitious could prove counterproductive if the public regards the necessary spending cuts to be too deep and the tax increases too large and elected leaders respond by abandoning the effort. Attaining fiscal sustainability is likely to require several major efforts over the next decade or two. Nevertheless, it is important that we start the journey now by enacting some significant deficit reduction measures that will send financial markets a clear signal that no longer will we behave as if American exceptionalism means on the fiscal front that the United States can avoid the unavoidable.

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2 Richard S. Foster, Chief Actuary, CMS, *Medicare Estimated Financial effects of the "Patient Protection and Accountable Care Act" as Amended*, April 22, 2010. CMS (OACT) estimates that the PPACA will reduce Medicare spending by $575 billion over the 2011-2019 period.

3 See The Peterson-Pew Commission on Budget Reform, *Red Ink Rising: A Call to Action to Stem the Mounting Federal Debt*, December 2009 and National Research Council and the National Academy of Public Administration, *Choosing the Nation's Fiscal Future*, National Academy Press, 2010.