CENTER FOR AMERICAN PROGRESS

PROGRESSIVES AND THE NATIONAL DEBT: ADDRESSING LONG-TERM DEFICITS: WHEN AND HOW?

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SARAH ROSEN WARTELL: Thank you, everyone, and I think that – actually better than we could have hoped, the segue between the two panels and particularly some of the questions will move us now to a discussion of when and how we can start to act, or if we should start to act to address some of the consequences that were talked about in the previous discussion.

I am hopefully – yes, in fact it happened – I put up one of the slides from John's presentation earlier in part because it's a timeline and gives us an ability to reference both revenue and expenditure projections, although we take Bob Greenstein's admonition that we should perhaps think about those categories as not as distinct as they may seem on the chart.

I also want to encourage everyone to keep in mind for purposes of this discussion the really terrific presentation from Charlie Cook this morning because obviously an important part of the discussion about when and how is not only when the swift kick in the pants might come from capital markets, but also, when a swift kick in the pants might come from the political, and where that comes from and how it affects our ability to make these choices.

To talk about those questions, we have a really terrific panel. I'm going to introduce everyone at the start, and then we'll go through. Sen. Mark Warner is with us – a great pleasure for the center to have him. He was elected to the Senate in 2008 after serving as the governor of Virginia from 2002 to 2006. As governor, he inherited budget shortfalls that ultimately grew to $6 billion – very large by state standards -- and left office four years later with a budget surplus having been able to make and find the resources to make significant investment in important progressive priorities important to the state's financial health. Prior to his time as governor, he was a leader in telecommunications and technology investment.

Next to him is Professor Paul Krugman whose New York Times column is almost certainly required reading to anyone who thought this was a good way to spend their morning. Professor Krugman has been on the Times' op-ed page for 10 years where he writes on politics, economics, domestic policy and international affairs. A Nobel Laureate in economics, he's professor of economics and international affairs at Princeton.

Robert Reischauer, and an expert on the federal budget, Medicare and Social Security. He was director of the Congressional Budget Office for six years, been responsible for making those projections. And from – back in – from 1989 to '95. He was also a member more recently of the Medicare Payment advisory commission and was its vice chair from 2000 to 2008.

Finally, Roger Altman is the founder and chairman of Evercore Partners, an investment banking boutique. Prior to forming Evercore, he was deputy secretary of the president – of the Treasury under President Clinton, and he was also assistant secretary of the Treasury during the Carter experience – great experience in wrestling with these challenges during prior progressive administrations.

So I want to thank everyone for being with us today and try to begin to disentangle not only the discussion of the consequences, but also our – beginning to think about when and how the political system could act to take up this challenge. We'd like to start with Sen. Warner, and maybe we could have a little more optimism and hope than we've had thus far in this morning's panel. As I said in the introduction, the senator as governor had great success in turning around these state challenges and perhaps there are lessons learned.

SEN. MARK WARNER (D-VA): Well, thank you, Sarah, and I appreciate the opportunity to be here. I think as a newbie senator, my role today will be at least to give you at least one short case study of how we take on some of these issues in Virginia. I only caught the tail end of the last panel. I didn't hear Charlie Cook's presentation, which – I'm probably glad I missed it – (laughter) – considering what I understand was the focus. And I have to tell you, I hope we get into a point to discuss, because I don't think that has to be – I can imagine what his prediction was – I don't think that necessarily has to be the case, but it's going to take a set of political courage that I'm not sure we've seen to date.

Let me very briefly run through a Virginia scenario because it could be a model or could be parts – it could be a model for how we take on this issue at the national level. Again, to set the stage, when I was hired to be governor back in 2001, Virginia was a two-to-one Republican state. No statewide elected official was a Democrat or a progressive. Our legislature was two-to-one in both bodies, mostly made up of a kind of – a no-caucus about anything around revenues.

I'll always remember going through the transition stage when I found that the budget shortfall that my predecessors said had been $700 million was in actuality 300 – 3.8 billion. My first reaction was, was it too late for a recount. (Laughter.) That ultimately grew to a 6 billion shortfall on a 32, $33 billion base, so a fairly significant challenge. And what we had in front of us was a structural deficit.

What we did was – you know, we didn't have the ability to print money in the basement in Richmond, so we had to take on this issue, but we did it in a slightly different way. We didn't try to hide the ball. We acknowledge we had a crisis. We acknowledge we had a structural deficit. We pounded structural deficit – structural deficit into a press corps that had never heard the term before, and then started to act.

First we cut. We made major cuts much to the chagrin of some of our allies. I have to tell you the cut that drove home the point more than any, though, were not all of the issues that I would have expected, but we ended up shutting down the department of motor vehicles one day a week, which resulted in the greatest outrage around. I think I was burned in effigy many places around the state. But the value ended up being that it drove home the point to the folks in Virginia that we had a real crisis, that this wasn't just, again, politicians saying we had budget shortfalls, which they have said year-in and year-out, and never having, when you see cuts, actual effects upon people's lives. We created something that was an actual effect. I didn't plan it, but it ended up being the case.

Second, we use this as a time to start a dramatic reformist Virginia state government. It is remarkable the threat of laying off state employees, what it does in terms of changing people's mindset about how you would operate within state governments. So we launched the most extensive reform of our IT system. We consolidated a lot of our procurement policies. We started looking at our real-estate portfolio the way a business would. We consolidated 70 boards, agencies, and commissions. And while in the period of – this was over 2002 through 2004 timeframe when we actually came around to the revenue side. We hadn't seen dramatic results. We were showing the public that we were first cutting, and then secondly, we were trying to change the way we did business.

The third thing we did that I don't think we have seen enough of outside of these kinds of settings, we sold the problem. We didn't try to start with selling a solution; we started with selling the problem. Time again – we have a proud tradition in Virginia that we had had balanced budgets, that regardless of Democrat or Republican, we had been pretty good fiscal managers, and we said all of that was in jeopardy.

And again, what ended up – and I would have never again predicted this – but what ended up becoming a rallying point was the credit agencies put our AAA bond rating – we were put on credit watch. And this became that kind of outside validator that the crisis was real and that we had to act. And it allowed us to rally the business community. It allowed us to find some good allies across the aisle. And building that coalition between business, some of the more moderate Republicans, we then went out to sell a solution.

I held 65 town-hall meetings. I was a mini Ross Perot with charts and graphs explaining, hey, if you've got a better option, we'll take it, but we were not going to simply punt this problem down the road; we were going to fix it during this administration or have the administration fail.

And a remarkable thing happened. Not unlike predictions here in this town, where when I put out this plan, it was basically – initial press reaction was, you know, Warner commits political suicide because I had a 2-to-1 Republican legislation – we found that we managed to make the case that it was not Republican-Democrat. It was kind of at the end of the day, who was for Virginia, and who wasn't.

And, again, we were blessed with having some strong Republican allies to start with, but we completely transformed the debate and ended up with a tax-reform package. It lowered some taxes, raised others – net-net raised about a billion-four ($1,400,000) in new revenues on a two-year budget cycle. That allowed us to then make large investments in education and growth in a series of other areas that were fairly remarkable – and from the progressive standpoint, allowed us to pick up. And now we control the state senate – allowed, I think my Lt. Gov. Tim Kaine to be very successful.

But was the perhaps more important point, Charlie, was that we had almost – in the Senate, about half the Republicans in the House – a third of the Republicans siding with us, and to much what they would have expected: political risk. But even though those folks who sided with us were targeted by Grover Norquist and his crowd, there were actually wanted posters put out around with the Republicans who had sided with us. They were going to be taken out in the next election cycle. All of them except one were successful. We built enough of a case, and there was enough kind of sensible center that emerged in Virginia that we were successful with this. Not only did it help the Democrats but those moderate Republicans were reelected and reinforced.

It led us then to not only keep that AAA bond rating. We got named the best-managed state in America. We got named consistently now for the last five or six years the best state for business.

How does this all apply on the federal level? I'm recognizing my time is running short. I do think there are lessons for this in terms of how we take on this critical issue at the national level.

One is I think before you start talking revenues, you've got to show your willingness to cut spending. And as Democrats at least at the national level, we've never been very good at that. And I think there was an opportunity actually around the health-care debate, for example, to form the health-care debate in the broader context of a grand bargain to also put in place a bipartisan entitlement and reform commission that would be voted up or down on a BRAC-like basis that might have shown the ability that we were willing to really be serious about the deficit.

Secondly, I think that there is enormous opportunity in consolidation around certain programs. I don't think at the end of the day, you know, you've got – before you – if you were ever going to go to the revenue side, that you've got to actually solve the whole problem, but you've got to show you're making progress.

And unfortunately, at least from – you know, I'm a new senator and soon perhaps I will not – I'll perhaps be more enamored with all of the things we're doing at the federal level – (laughter) – but, you know, it's shown time and again that we have massive program overlap in very worthy policy areas, but we've never gone at this from a perspective of saying how do we do that program consolidation, how do we look at things like technology, HR, procurement, on a horizontal basis across government agencies to really show that we as Democrats and progressives can actually be the party that tries to be about better spending of dollars.

You know, I think we have to show the American public the anger that's out there, particularly not all of it by any means, you know, I think authentically generated, but it is out there. I had a town hall meeting with 1800 of my closest friends a while back in Fredericksburg where I got yelled at by both sides on a continual basis, but, you know, we've got to show that we can ratchet back some of the spending, and I think a bit of that could go a heck of a long way before you start talking about some new program.

And finally I guess, you know, on the subject de jour which is health-care reform, one thing that I wish we would have – where I wish we would have started this debate – I think the administration understandably started this debate around coverage and around social justice issues.

I wish we would have candidly started this debate around the financial imperatives about starting – that if we don't start – if we don't do health-care reform, what it will do to the 85 percent of us who have health-care coverage in some form or another, that we will still a bankruptcy of Medicare by 2017, that we will see on one of those earlier slides Medicare and Medicaid – other than paying off the national debt be the single largest driver of our national deficit, that we will see an average family of four spending 40 percent of their disposal income on health-care costs, even if they still have coverage, and that we will seriously impede America's ability to compete in a global economy if we've got to pay three or $4,000 more per employee for health-care costs.

I think we could have built the basis of this debate around economic principles and around actual fiscal sanctity principles, and that we might be – had been perhaps more successful. I think we will still be successful around this health-care reform, but I know a number of us freshman Democrats – we had 10 of us on the floor last week talking about these issues. And I don't think at least from the Senate standpoint, there is a wonderful opportunity. I don't think – those of you who are congressional historians will know better than I, but we now are at I think 22, 23 new Democratic members, elected or appointed since 2006. That is a big group of folks who have been hired in the recent cycle who I think are willing to take on these issues in perhaps a bolder way than we have in the past. So I look forward to the conversation.

MS. WARTELL: Terrific. Thank you very much.

Paul, you've been blogging in the last week as you prepared to come here a bit about your thoughts, and specifically to this question of when and how. Perhaps it sounds like you may have a slightly different perspective to some of the earlier panel. Do you want to take that on?

PAUL KRUGMAN: Yeah. Yes. Okay, so – yeah, first of all about when. Alan Blinder already used my favorite quote, but not quite in the version I prefer. So it is St. Augustine. And at least one of the – one of the translation says, "Oh, Lord, make me chaste and continent, but not yet." (Laughter.)

This is a really bad time to engage in fiscal retrenchment. It's a bad time on almost every dimension. Where we are is we have in effect a global excess of savings. The amount that people around the world want to save or would want to save if we were at anywhere near full employment is greater than the amount that people around the world are willing to invest even at zero short-term interest rates. So we have this, in effect, excess saving problem in the world.

In that world, government spending does – government deficits do not crowd out private investment; in fact, they crowd private investment in. Think about what would happen if we tried to – you know, if we canceled the rest of the stimulus program. The economy would shrink, would be more depressed, and private investment would fall because we're in a situation right now – private investment has already fallen sharply, not because interest rates have risen – obviously they haven't – to some extent maybe because of constraints owing to the financial crisis, but mainly because businesses don't want to invest because they're awash in excess capacity.

So this is a situation in which actually if we can – everything we can do to support the economy actually tends to increase investment. Government – again, deficits right now crowd investment in; they don't crowd it out, which means that people talk about trading off current benefits for – at the cost of hurting future – the future – hurting future generations. Right now government deficits are actually helping the future as well as the present by helping to sustain investment. This is just the normal tradeoffs do not apply.

I like to say that we're in this situation where interest rates are up against the zero lower bound with this excess of savings. It is for the time being a sort of Alice in the looking glass – Alice-through-the-looking-glass world where none of the usual rules apply, where virtue is vice, where prudence is folly. And in this case, doing the prudent thing about deficits now would be an extremely foolish thing even from the point of view of the fiscal situation because if you try to retrench fiscally now, you shrink the economy which means that some, not all, but some of the savings are offset by a reduction in revenues, and you also shrink the future economy, which means that you hurt future revenues as well.

The IMF just recently released one of the chapters from its next world economic outlook in which they found, first of all, evidence that financial crises not only lead to very severe recessions but tend to put a large crimp in the economy a number of years out, seven years, that their – the medium, medium-long-term growth of economies is badly hurt by financial crisis. And the evidence suggests that you could reduce that impact by having strong effective fiscal and monetary policies to limit the extent of the recession, so that doing – deficit spending – we don't like the deficits, but that deficit spending right now is the right thing to do not just for right now but for the future, with the total folly to retrench now.

Okay, that said, eventually we have to do something. And so the question is, well, when? I think the answer is actually – it's when we get onto the right side of the looking glass, once we get back into a world where – what the Taylor Rule says the Fed's fund rate should be is not where it is right now, which says it should be minus 500 basis points, but back into positive territory so that monetary policy is playing its normal role and we're in a situation where we are back in the world where fiscal deficits crowd out private investment, where we are back in the world where prudence is prudence instead of being folly.

When that will happen – you know, if you believe – if you believe the official forecasts, we're still several years from that point. We're still going to be in a world of very high unemployment, a long way from – you know, right now basically the official forecasts all say that we finally return to something like full employment about five years from now, and the reason they say that is because it's a convention of projections, that you always assume that you return to normal in five years. (Laughter.) So the reality is we have no idea, but it could be quite a long time.

Okay, assume that we have a – (inaudible) – assume that at a certain point we do get back to normal, which I – someday we will – what does the longer-term issue look like, and what do we have to do? And I've been trying to think this through. I've been blogging on it a bit. I've been thinking about 2019 just because that's the furthest outdate for which we have official projections. In 2019, you got your choice of several different projections here. OMB is the most optimistic. CBO is worse. Depending on which of the two CBPP pieces we just got here, they're somewhere in between. Let me take OMB and you can mark it down accordingly.

OMB predicts that as of 2019, we will have a deficit of 4 percent of GDP and federal debt net of financial assets acquired through the TARP and all of that of about 70 percent of GDP. Now, a typical assessment of fiscal sustainability, or one criteria anyway, is can we stabilize or reduce the ratio of debt-to-GDP? Are we on a path that will make that go down? And if 2019 looks like that, we will fail to meet that criterion, although not by a lot. If we have debt at 70 percent of GDP, real growth is 2.5 percent, which is our best guess. If inflation is 2 percent, which is the target, then that means that you can have a deficit of a little over 3 percent of GDP while stabilizing the debt GDP ratio.

So we'll be a little bit out. Now, of course, the important thing to remember about this prediction or this analysis is all of those numbers are totally wrong. The only problem is we don't know which direction, but anyway, this is a sort of guess. But what I think you can say is that a reasonable assessment is that in 2019, we will be not in a fiscally sustainable position but if that was the end of the story, not too far off either, that a moderate amount of spending cuts or additional revenue would appear to stabilize the budget around them.

Now, of course that's not the end of the story because other stuff happens. Other stuff probably – some certainly, but other stuff predictably is going to happen after 2019. And the two things that are going to happen are demography for sure, unless we go – unless we actually do have some death panels – (laughter) – and health-care costs.

Now, by 2019, as Alan said, 2010 is just around the corner. Actually, the baby boomers are already hitting the retirement programs, certainly are already hitting Social Security because of early retirement. By 2019, the demographic transition will be about half over, which means that there won't be that much, although still a significant push from aging of the population. And if that were the whole story, we'd be looking at another roughly 2.5 percentage points of GDP in expenditure to provide for Medicare, Medicaid, Social Security, Medicaid not being a program for the elderly on paper, but in practice being about 70 percent the program for the elderly. That would bring us up to needing to do something three-and-a-half or four – or if you buy the more pessimistic projections, five or 6 percent of GDP has to come from somewhere eventually to bring us into a sustainable fiscal position.

The other thing is health-care costs, and if they continue – if we continue to have excess cost growth – if health-care costs continue to rise faster than GDP per capita, then – well, then it's hopeless; forget it. So I guess you have to do is the – sine qua non of any of this is you have to assume that we somewhere along there get health-care costs under control, which means that if we can do that – and that's a tremendous if – then we have a 4 or 5, 6 percent of GDP slowly over the long run. That's big, but it's not huge, is the way I would put it. You can always throw around these present discounted values of entitlement programs and come up with these gigantic number which sound like, oh, we're doomed.

If it's actually 4 percent of GDP, that's a number that could be given a political – given a – I put this on the blog, I said, "given a halfway sane political process." (Laughter.) And my commenters (ph) immediately said, ugh. But given a halfway sane political process, that's not an impossible number; we could do that. Well, we could do it entirely from taxes. Even if we did that, we would still have overall taxation in the United States shared GDP well below that of most other advanced countries. So it could be done entirely through taxes.

One thing I think we might want to think about, if we're trying to think about these longer-run outlooks, is that the other big long-term issue, the even bigger long-term issue, which is climate change actually does intersect with this. If we get around to a situation in which emissions permits are mostly auctioned of – which, by the way, even Waxman-Markey is supposed to happen eventually – then that becomes a pretty significant source of revenue just in itself. But still, maybe other things – you could say, well, how about a VAT on top of that. All of that would still be taxes at levels that are well within the range that other advanced countries were able to do fine with.

Spending cuts. You know, what if we could do more than roll back – more than freeze excess cost growth. Other advanced countries get better health-care outcomes than we do spending 10 percent, not 16 percent of GDP on health care. Maybe there's something there.

Social Security. Everybody's going to – I've been on this many times. People talk as if there's a program called Social-Security-Medicare-Medicaid, one word. The truth is it's Medicare and Medicaid; they're the big stuff. Social Security, I think even if you go through some kind of radical downscaling there just isn't much there. We'll be spending around 6 percent of GDP or less on Social Security. You can't do very much by way of cutting – without emasculating the program entirely, but it's in there.

Defense – you know, maybe it's a more peaceful world and we can spend less on defense. I think the point of all of this is that actually – I think this pretty much came out of the previous panel as well, that the economics of this are not easy, but they're not spectacularly difficult. It's not at all hard to tell a story where a combination of health-care reform, tax increases that still leave us as a relatively low-tax country, and maybe some other – some cuts in preferred spending actually put us on a sustainable fiscal path.

If this all sounds like a pipedream, it's because of our political deadlock. And what we have to do is hope, what we have to assume is – if we want to be able to get through the day – is that 10 years from now, we will have a much saner political landscape than we do right now. And sometimes, if I'm feeling especially optimistic, I can even believe that that might happen. Thanks. (Laughter.)

MS. WARTELL: It will be interesting to have us come back and talk about why 10 years from now we're more likely to have a saner landscape –

MR. KRUGMAN: Yeah.

MS. WARTELL: – than the current alignment of forces. I hope we can talk about that a little more.

Bob, it's my understanding that you probably have a little more immediate view of urgency. Laura used the term "pre-committed" to talk about how we might begin to describe the path between now and 2019. Do you want to talk about your views there?

ROBERT REISCHAUER: Okay, there's a little gap between Paul and myself here physically and intellectually I think there's a larger gap – (laughter) – because I am in a sense a blinder-right on steroids. My hope would be that we would begin to deal with our long-term deficit problem in the next presidential budget and in the next session of Congress. And I have six somewhat interrelated and somewhat familiar, given the discussion in the first panel, reasons for suggesting this course.

But before I elaborate on those six reasons, I want to make it clear that I'm not talking about imposing any kind of significant spending reductions or tax increases in fiscal 2011 or '12 or '13; what I'm really talking about is making decisions next year that put in places policies that would kick in before the economy is stronger. And I have no doubt in my mind that should the economy not follow the path that we hope it follows and be strong by – relatively stronger by 2014, 2015, that our political system will be able to readjust the implementation dates for some of the measures and put them off two or three years until a better time.

What are the six reasons? First, I think it's important that we send the signal to our creditors that we both recognize the long-run fiscal problem that faces us, and that we have the political fortitude to take some difficult actions to address it. If we don't, as the first panel suggested, we run a risk of possibly higher borrowing rates, possibly less certain supply of credit. And as Laura has pointed out, the world going forward is likely to be different a little bit than it has been in the past. We are not alone in running large deficits. Other countries are out there in the market as well trying to borrow the generators of surpluses that were invested in U.S. treasuries and British bonds and other things with the fall of oil prices, with the fall of trade surpluses, with the desire to invest in domestic economies, could be less going forward at a time when the demand is greater.

Second, the longer we stay on the unsustainable path we're on, the higher the risk that some form of catastrophic failure will occur. I think Alan and Laura made a convincing case that economic imbalances are not likely to cause us the careen off the edge of a cliff in the next, three, five, seven years. But if history tells us anything, it suggests that when world economies are fragile, unstable, there's a general lack of confidence in the financial system, economic collapses can be triggered by non-economic events, by political – the political environment changing natural catastrophes, whatever.

If recent months have shown us anything, we're living in a very, very uncertain world, where a number of governments that are important to us and our political and economic situation are unstable, where terrorism is a real possibility, where mistakes of military intervention can occur, and there is also the possibility, as Alan pointed out, that the fragility and uncertainty of this environment – political-economic environment we live in will lead some country to pursue its geopolitical objectives, be they territorial, economic, or political in a way that destabilizes the world.

And you can just go through the countries out there which are in the newspaper every day: North Korea, Iran, Israel, Pakistan, China, India, Venezuela, you could all come up with a scenario, each one of which would have a tiny probability of occurring, but when you sum them up and then look at them over a decade, there's a level of risk that we shouldn't be entertaining.

Third, I think if progressive priorities are to be preserved, it's best to address the painful and unavoidable adjustments that are going to be needed in a measured and deliberate fashion and not in an environment where we are forced to act precipitously in situations where our political system will have to respond to some external shock or some internal problem. It's likely that the interests of vulnerable groups are going to get trampled, and it's going to be those who give political contributions, those who have assets to protect that are going to call the tune.

Fourth, it would be best to make the unavoidable decisions about tax increases and spending cuts in a political environment that is sympathetic to the progressive agenda. And I don't claim to have any expertise on this. I have a gut feeling, and my gut feeling I think was confirmed by Charlie's remarks early on. And my gut feeling is that the current lineup we have in Congress and in the White House is probably more in tune with a progressive agenda now than any we will see in the next 10 years after the mid-term elections. And so this offers I think an opportunity that maybe isn't great, but this is a relative world, and it's what is it going to be like in the future.

Fifth, it's highly likely that the spending cuts that will part of any significant adjustment are going to involve some reduction in the growth of benefits for core entitlement programs. And I think the sooner you define what those are, the better it will be for Americans at all income levels, but particularly for those who have limited ability to respond. We want to phase them in as gradually as possible. We want to give people as much of a warning as possible.

A corollary to this is the longer we wait, as Alan has pointed out, and Paul also, the larger the cohort that is in the "I'm getting Social Security, Medicare benefits, other retirement-oriented benefits" will be. And the more difficult it will be to reduce the benefits of those people in this room when you age – (laughter) – you know. And that in a way really has to be part of the solution, that we dial back a little bit the benefits that upper middle-class people receive from these programs.

Sixth, and finally, it would be best to address the problem when our leaders have some ability to force others to follow in the directions they want to go. And, you know, given the difficulty the Obama administration, the leadership in Congress right now are having getting their agenda to move forward, you might say, what's this guy talking about? And what I'm really talking about is the expiration of the tax cuts. And this is going to happen if Congress does it what does best, which is procrastination – (laughter) – this, an aggressive and bold leadership could use this as a club, I think, to shape in a progressive fashion the deficit-reduction measures that would be implemented over the longer run.

Let me conclude just by saying a few words about the second charge that this panel had, which is, well, how would you do it? And like others, I think first and foremost, the issue is health-care reform, that we really need to bend the curve. Now, Alan correctly said, everybody says that, but nobody knows really how to do it. And that is true, but if you took the consensus of health experts, they would suggest that the curve is not going to be bent until we change the incentives in ways that will modify the delivery system, and that the best prospects for that involve integrated coordinated care, payments for broader bundles, like capitated payments, risk-adjusted, and bonuses for performance. And one has to ask if we think that's the right way to go, why don't we say, if you want the full tax advantage that we give out now, or you want a subsidy through exchange, your plan has to comply with that formula. I don't think there's a whole lot of will to do that, but I would move in that direction.

Second, I think we need to consider new sources of revenue, probably devoted to some progressive purpose like universal health care. And here I'm sympathetic to a national value-added tax, which I think would be a whole heck of a lot more equitable and transparent than what we're proposing now, which is to place fees on insurers, device-makers, hospitals, pharmaceutical companies that are going to be passed through in mysterious and invisible ways on the premiums everybody pays.

And third, I think we need sensible Social Security reform, although I agree completely with Paul, that this isn't the big deficit-reducer; what this is, is trying to align the benefit package to the demographic, social and economic realities of the 21st century.

MS. WARTELL: Great. Thank you.

So Roger, is the swift kick in the pants coming, and what can we do and when should we act to try to reduce the risk of that swift kick?

ROGER ALTMAN: The short answer I think, Sarah, is yes. (Laughter.) First of all, I'd like to thank John Podesta and CAP for putting this conference on. I think it's –

MS. WARTELL: Move the mike a little closer. Thank you.

MR. ALTMAN: I think it's quite impressive that you've taken the initiative to do this, and it's a pleasure for me to be here amidst such a distinguished group.

So the questions are when and how. I think everyone agrees with Paul Krugman that this is not the time today to actually implement deficit reduction, and Bob just discussed that too. Economic conditions are too weak, and fundamentally the contractionary impacts of deficit reduction could not be absorbed today.

So the question is, if not today, when? And that gets into the very fundamental question of whether we'll choose to address this deficit outlook on our own terms, or whether we'll be forced to address it on other terms. I don't precisely know of course, but I tend toward the second scenario. Why? Because the fiscal outlook is simply so dire that it is likely to transcend the capacity of our political system to address it proactively.

Now, let's remember – and I'm using the forecast here in the Auerbach and Gale paper. The 10-year path involves average annual deficits of a trillion. At the end of that period, they would equal 6.5 percent of GDP and be rising. I know that's hire than the numbers Paul used, and we can debate those, but these are reasonable forecasts. And by the way, that's of course after economic recovery has fully occurred. And the national debt at the end of that period will have reached 80 to 85 percent of GDP. That's a figure that we haven't seen since the late 1940s.

But I think the larger point is that for a nation whose national savings is essentially saving, nearly all of whose increased borrowing in recent years has been furnished by foreigners, more than half of whose debt today is owned by non-citizens, and where the ratio of combined Medicare and Medicaid spending to GDP is projected to triple beyond the 10-year window, this is a truly dire outlook. It's not just a bad deficit path; it's really dire.

And it's so dire of course that it won't actually occur. This isn't actually going to materialize. Why? Because the financial system won't accept it. And listening to Charlie Cook and others that are a lot smaller than I am about that, it doesn't look as though the political system will accept it either. Let me expand for a minute, though, on the financial system point. We've of course seen repeated global financial crises in recent years, especially the so-called great panic of 2008. But there's also, let's not forget, the Asian financial crisis, the Mexican default, the Russian default, and it wasn't so many years ago that the IMF was an emergency lender to Britain.

Now, every one of those crises had one element in common: excess leverage, too much debt. So in my view, it's virtually certain that the rest of the world will not indefinitely lend whatever colossal amounts we need at current interest rates and exchange rates. They simply won't take the risk of that amount of excess dollar asset concentration.

And that point is reinforced by the story which Bob Greenstein told of 1979. I too served in the Carter administration, and it's really a very instructive story. Global markets lost confidence in the Carter economic policies. And finally when President Carter submitted his early 1980 budget, as Bob told the story, markets revolted. The dollar essentially crashed and emergency international intervention was organized to stabilize it, and that involved some very punitive actions like, for example, tightening monetary policy and raising interest rates on the part of the fed here, and also, as Bob described, drastically tightening our then paltry budget, President Carter retracted his budget, and a week later – not a month later or a year later – a week later submitted a budget having his proposed deficit.

Now, finally on timing, these things are impossible to know because they involve so much psychology, but it's my judgment – a little different than Bob Reischauer that we will not get through this first Obama term without actually implementing rather than committing to later implement at least the beginnings of long-term deficit reduction.

Then the question is how. That gets, it seems to me, to the size of the fiscal gap and this question of whether we'll do it voluntarily or we'll do it involuntarily. But the amount – and that fiscal gap of course is simply the amount of immediate annual deficit reduction which would be necessary to stabilize the relationship of the national debt to GDP. Chairman Bernanke has been in effect urging that we stabilize it at the current level, which is about 55 percent, highest since 1954 by the way, as the World War II debt was winding down. That would require about to 1.4 trillion of immediate deficit and annual deficit reduction.

So if you say to yourself, we'll ultimately stabilize it between the current level and the 80 to 85 percent level that would play out under the 10-year forecast here because we won't actually be allowed to get that far, you're talking about something like five to 700 billion of annual deficit reduction meaning obviously a combination of spending cuts and revenue increases to that effect – five to 700 billion.

Now, realistically, most of that is going to have to come from new revenue. It can't all come from new revenue, but most of it will have to come from new revenue. Choose a number – 400 billion, and that's just a number I've chosen just for illustration. Now, that likely requires, as Bob Reischauer just said, a new source of revenue. And I agree with him, that a national value-added tax would be a good possibility.

But the fundamental question, coming back to the very beginning, what Charlie talked about, is whether our political system is capable of proactive voluntary agreement on, for example, new revenues of that magnitude. I'd like to think that the story Senator Warner told about his experiences in Virginia could be replicated on our national stage, but I'm skeptical. And so if that skepticism proves right, then the solution will be imposed upon us. Unfortunately though, imposed solutions, as we saw on a much smaller scale, Bob, in 1979, tend to be very punitive, and especially punitive to progressive goals and to the most vulnerable constituencies, and that's what worries me the most.

Thank you, Sarah.

MS. WARTELL: I'm very conscious of time because I do want to get the audience in, but there's such a rich vein here. So I want to put two different topics on the table and ask everyone to go through and do a speed round if they possibly could and try to bring them both up.

First of all, I wanted to give the optimist's side of the table a chance to respond to the pessimist's side of the table. (Laughter.) We seem to have moved through the discussion. And I'm going to ask you to do the same time you take up the second topic as well.

Charlie Cook described the views of purple America as fearful of a kind of dangerous encroachment of the role of government, and that purple America doesn't have a great deal of confidence in government's capacity to use tax revenues well and to achieve public ends.

How does that sort of disillusionment of purple America and this deficit discussion relate? Does not in fact the amount shattering classes' discussion about deficits and debt in fact fuel that, and does that potentially create before the markets react a political imperative for our system to behave in ways that perhaps it hasn't before? So two questions at the same time if we could go down the table and try to bring – keep answers brief so we can bring the audience in.

SEN. WARNER: Sure it does. I think that the president and the Democrats overall have been in effect blamed to a certain degree for some of the fact of actually honestly in budget – you know, putting the costs of the wars back on budget, recognizing that some of the extraordinary actions, TARP, for example, taken under President Bush were necessary. It has created that sense of this overwhelming – and I missed Charlie again – but encroachment.

And I don't disagree with Paul in terms of the fact that right now cutting back on stimulus, cutting back on TARP, as imperfect as they were, I'd vote for them again. But the notion that we shouldn't start at this moment of crisis to show, particularly echoing what Roger's point is, that if we're going to go through this realignment of spending, that we ought to drive that ship. And if we can't regain the confidence of the American people, that we can get better value for our tax dollar. If we can't show that we can constrain some spending – and it doesn't mean this fiscal year, but at least putting on a path to that, I think we will completely see the field, one, to the opposition, and two, I think that if anyone thinks that short of showing discipline on spending and on government productivity, that we can simply take the current status quo and suggest that we're going to add revenue enhancements – I love the new terms that we call taxes – you know, into the mix, I think we'd have zero chance of success.

MS. WARTELL: Paul.

MR. KRUGMAN: I'm not sure I have a full diagnosis or an answer or anything here, but I would disagree with Sen. Warner about what's been driving the debate right now. I thought that Obama actually talked a lot about costs in the early stages of the health-reform campaign, that that was in fact the centerpiece of the argument, but it didn't get through, and that the public backlash is being driven to a large extent by misrepresentation of what the cost-control measures would do.

And let me – I was optimistic about the possibility, the feasibility in economic terms of dealing with this. Politically I can be as despairing as anybody. And – (laughter) – and let's just talk about – let's just talk about how this debate has played out so far. In the health-care reform, we've had – you know, the aim is to bend the curve. Whoever is responsible for that phrase originally, should, by the way, be shot. (Laughter.)

But the – so two things were in there that would at least bend the curve, at least save significantly perhaps on Medicare expenses. One was incorporating comparative effectiveness research, which, you know – let's not spend money medical procedures that actually hurt people. The other was reducing the access payments for Medicare advantage, which is an unintentional entitlement program, right, one that was sort of snuck in and then produces very poor value for money.

Both of those have been treated as horrible things – death panels, and – you know, so this is – the problem has not been the failure of the Obama administration to call for spending restraint and cost-saving measures; the problem has been that in our political constellation, the opposition will demagogue any cost-saving measure. And it's a peculiar thing. I mean, as we've all noticed, the GOP, which has been the party which denounces runaway entitlement spending then starts screaming death panels at the first hint of some attempt to actually spend entitlement money better.

But it's actually quite simple. The goal – the campaign against entitlement spending is not about fiscal responsibility; it's about eviscerating the social insurance programs. And essentially today's political opposition will not accept any form of spending cuts that strengthens those programs as opposed to disemboweling them. And that's a very difficult scene. I don't know – something has to change. Now, if Charlie Cook is right, the next election is going to move it further away from being able to discuss these things rationally.

So somewhere along the line I hope we get through this, but let's be clear: We are not having a rational discussion, okay. We are not having a remotely rational discussion and we shouldn't be basing our discussion on what we can do next on that false perception.

SEN. WARNER: Well, I just – I mean, one of the disadvantages of going first is everybody gets to respond; I just have to, again, respectfully disagree. I've heard a lot of the president's presentations. He has raised these points. But at the early stages, I believe this initiative – as somebody who's started a health-care foundation to deal with the uninsured in Virginia 18 years ago – I've been dealing with this at the front end – was more about expanding coverage and telling the very true human stories of people who didn't have coverage or had inefficient delivery of the current system. When I think, you know, my two cents would have been I would have started the discussion with much more about the cost of doing nothing, that the current system will financially collapse over the next two decade if we do nothing – and perhaps raise that concern to a high enough level and then say how do we fix it. But I think, again, we will just probably agree to disagree.

And that was – from the folks that I hear who have been on the – you know, I had been on the frontline in these town hall meetings. And I do love – and I will agree there's a lot of misinformation. Paul, there was one of them – my great point and my 1800 friends in Fredericksburg, after being screamed at for 90 minutes, I did finally raise the question – I said, now, how many all are on Medicare. Seventy-five percent of the audience raised their hands. I said, you know, Medicare is a government program. And everybody, said, no, no, no. So there is a little bit of misinformation in the debate going on. (Laughter.)

MS. WARWELL: Quickly, Bob and Roger.

MR. REISCHAUER: I don't think the situation is going to change until the American people and purple and other states view some activity of government as a significant success. And the real problem here is that people compare – they don't know what the counterfactual is, and that's really what the senator pointed out. They're comparing health reform to what they have now, not to how the health system will be in 10 years. They're comparing the economy to what it was like when it was, you know, unreal several years ago rather than what it would have been like had we not intervened. And I think the hope we have here, as Alan pointed out, is that the economic recovery occurs faster and with more vitality.

Just one final point, so Paul will know what he's looking for when he goes hunting, I believe that it was the Commonwealth Fund's Commission on High-Performance Health Care that coined the term, "bending the curve." (Laughter.)

MS. WARWELL: Peter Orszag has been spared. (Laughter.) Roger?

MR. ALTMAN: Well, first of all, Sarah, I don't think discussion in groups like this, or as you described it, rather pejoratively, as the chattering class, are particularly contributing to attitudes on Main Street or out around the country. I think the impact of that is very small. I think there's a very, very difficult problem here which is – and it's illustrated by Sen. Warner's story about Medicare as a government program – no, no, no. The reality is the level of deficits and debt are actually exploding. America remains, it seems to me – I'm not anywhere in Charlie's league – a relatively conservative country. And people don't understand that, and they don't connect it to the necessity of economic recovery and the importance of stimulus and so forth, and they react viscerally to it.

But unless, it seems to me, there is post-health care a big effort to, along Bob Reischauer's lines, commit Washington to deficit reduction – we can debate when it should be implemented, but commit that – and educate the public further about the reasons we're in this position, but then the importance of getting out of it and the degree to which action is going to be taken, then my scenario, which is that the solution is imposed in us, rises further in possibility or in probability.

MS. WARTELL: Right, we are running, but it would be unfair to deny the audience some brief questions. So the microphone is there. Why don't you move – there's one right there, so why don't we start with the gentleman in the blue shirt right next to the mike? Please stand up and identify yourself.

Q: Thanks. My name is Lee Diamond (sp). I hope I'm not too much of a problem for Sen. Warner, but I'm a constituent. (Laughter.)

I was amazed, frankly, what Mr. Krugman said about 10 years from now, because we've got it right now, and you know, we need a public option, whether we need a carbon tax, or whatever. You guys got to do something to take back to everybody up there. And I worked my butt off for Democrats. So we've got to take the ball and we've got to run. And do deficit reduction – that's fine, but please act.

MS. WARTELL: All right, what I'm going to do is actually take two more questions and have the panel respond to them all at the same time. I don't know where the mikes are. We have one right there. The closest to you, heading straight back, and then one – the gentleman next to you. So we'll do those two questions. Yeah, so, go ahead please.

Q: Hi there. My name is Justin Strackle (ph). I'm a college student.

Mr. Krugman, you kind of just for a moment jokingly said maybe the world will be a more peaceful place. Sorry, in the recent discussion the military was not raised after that or prior to that, and I'd like to hear your thoughts too, Senator, being from Virginia. Do you think that that's not talked about with the public enough and how much money we are spending on the military and the actual cost benefit analysis just to reduce that spending? Why do we have so many thousand tanks on the ground when we don't have the Soviet empire to compete with anymore?

MS. WARTELL: And the last question there and then we'll –

Q: Hi. My name is Clark Reinstein (sp). I'm another Virginia blue-voter. But my question really is why isn't the public option – can you legitimately say the public option is one of our best means to reduce the curve – the cost curve, bend it down given it would add more competition and not just have the insurance company's control? Thanks.

MS. WARTELL: Great. So health care and defense. Anyone want to –

MR. : Who wants to start? Why don't you start and then I've got a bunch – (inaudible, off mike) – start on that end.

MR. : They asked you a question. (Laughter.)

MS. WARTELL: Go ahead. Paul, you go first.

MR. KRUGMAN: Yeah, on that military – I should know off hand what the share of GDP we're spending on defense is right now, but it's a –

MS. WARTELL: We will discuss it in the next panel.

MR. KRUGMAN: It's somewhere south of four.

MR. : A little below that.

MR. KRUGMAN: And, yeah, so okay. And, yeah. I mean, this is – even I – even on the happiest days I don't imagine we can have a world with no defense budget. So this is a little bit like Social Security in the sense that – but actually better than – there's the possibility – I can imagine that we could get 1 percent of GDP out of lower defense spending. And that would help significantly. It's not going to solve the whole problem. Even if you eliminated the defense budget, it's not going to be enough to solve the whole problem, but it would help.

And you do have to – (inaudible) – we still are to some extent – I probably shouldn't say anything. There will be a panel – but we are to some extent still have a military posture designed to stop the Soviet tanks from rolling across the north German plain, and that's probably not something we should be doing at this point.

Public option – yeah, I mean – I can't tell you what – I can't figure out the political state of play, but it is a little bit shocking that we have something, particularly the Rockefeller version, which is good policy popular with the public would, according to CPO, quite a lot of money over the next decade, and it's a non-starter. That is something – I mean, it's no mystery about why, but it is pretty shocking that we can't do this.

MS. WARTELL: Go ahead, Senator.

SEN. WARNER: Just a couple of comments, one on defense. I mean, let me go even back a little bit overall. We do kind of wring our hands at these sessions, but one thing I think that we have again not done a very good job of, as imperfect as the TARP and the stimulus were, if you would have asked any of the economic prognosticators in March would you accept an economy at the beginning of October where the Dow would be up close to 45 percent, where banks were repaying TARP funds, where you had a couple of months straight of fairly good housing starts, you would have been called Pollyannaish and wildly overly optimistic.

And I don't think we've done enough job to say, again, as imperfect as some of these actions have been, we are in an exponentially better place than we would have been have we not acted. And I think again those of us in Congress, the administration don't make that point enough and often, I like to say, on the stimulus only, the Democrats would allow within the stimulus about a $200 billion-plus tax cut to be called a spending program.

On defense, I think there are things. I mean, we – this president was the first one to take a major military program like the F-22 and actually get the Senate to vote it down. And I think one of the areas around defense where we can better make the case – and I absolutely believe climate change needs to be addressed – but I think the way to make the transformation around our energy policy is to make this policy much more around national security, around job creation and not just about climate change.

And CNA did a remarkable study a couple of years back that I think changed some senators' thinkings about the enormous amounts of costs that we spend just protecting our shipping lanes in terms of protecting oil coming in and out of this country. And so I do think there are areas there.

Around health care, I think simply expansion of a Medicare and Medicaid system that don't have any kind of fiscal controls, and in terms of aligning the financial incentives right isn't going to get it done. I do think we need more competition, whether a co-op, whether a trigger on a public option. I do think the greater problem here is going to be much bolder action around transparency.

I'm a free-market guy, but there is no free market in health care. We don't know what anything costs. We haven't had the political will to force that. You know, as a guy who made a fairly good living out of the cell phone industry, thank goodness government finally set a standard around how we use spectrum. We need the same kind of spectrum – we need the same kind of standards set for health-care IT. IT has not transformed one-sixth of our economy. It can bring power, drive down costs.

I think we have to – echoing what I think Rob said is I do think we have to be bolder about moving away from a fee-for-service model. It's insane that we overly compensate hospitals who have higher readmission rates than those who don't. And there's not in the bills that do that.

I will say one other item that I am – that will – just to be a bit more provocative – I am concerned on one thing as we – that we learn a bit from the Massachusetts model on health care, that as we move – and I absolutely support expanded coverage and making sure that we cover folks – you got to get it right to get the system right. But I would hope that as we add this new benefit package, whether it's the up the 133 percent of poverty in the Medicaid population or the 133 up to 400 percent that we're talking about, that will receive some level of subsidies, that we at least start withdrawing that benefit design plan fairly narrowly and grow that – grow that program, and grow the coverage rates as we, again, try to lower our costs.

I am very concerned that we end up with at too-robust benefit day one that is not financially sustainable. And I know the president has said we will then at some point down the line cut that back or put it off. But I'm afraid that if we set up a too-robust benefit plan to start with that its government never takes anything like that away and it could lead to a financial unraveling a few years out that has not been part of the debate so far.

MS. WARTELL: Well, I think that's a great place for us to end. So on behalf of the Center on Budget and CAP, I hope the rest of the audience would join me on thanking this really terrific panel. (Applause.)

(END)