July 2009

Drowning In Red Ink

A SYMPOSIUM
Unprecedented Federal Debt:
Putting Our Fiscal House in Order

BIPARTISAN POLICY CENTER

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The Bipartisan Policy Center is a non-profit organization that was established in 2007 by former Senate Majority Leaders Howard Baker, Tom Daschle, Bob Dole and George Mitchell to provide a forum where tough policy challenges can be addressed in a pragmatic and politically viable manner. We seek to develop policy solutions that make sense for the nation and can be embraced by both parties. After reaching shared policy solutions through principled compromise, we then work to implement these policies through the political system. The BPC is currently focused on the following major issues: health care, energy, homeland security, national security, science and transportation. Each of these efforts is led by a diverse team of political and business leaders, policy experts and academics. To learn more about BPC and its projects, please visit www.bipartisanpolicy.org.

A MESSAGE FROM
Senator Pete Domenici

This booklet summarizes a symposium on federal debt and deficits sponsored by the Bipartisan Policy Center, where I am currently a Senior Fellow. The event entitled, *"Putting Our Fiscal House in Order: Unprecedented Federal Debt"* was held in Washington, D.C. in May 2009.

The symposium took place the day after the Trustees of the Social Security and Medicare systems made their annual analysis and concluded that both systems faced insolvency much earlier than their projections just a year ago.

At almost the same time, Congress passed its FY2010 Budget Resolution. That document acknowledged that even if many new initiatives passed Congress, deficits would be almost $2 trillion in FY2009 and nearly $1 trillion annually for years to come.

What follows are highlights from the presentations by federal budget experts universally acknowledged as the best we have—experienced in both the Congressional and Executive Branches of government, who have had the highest responsibility to inform Congress, the Administration, and the American public about the nation's fiscal state of affairs.

I think we succeeded in giving a balanced and bipartisan view of the current problems and the way ahead in this symposium. Experts from both sides of the aisle, Democrats and Republicans, participated.

Finally, we were honored to have the keynote address delivered by U.S. House Majority Leader Steny Hoyer (D-MD), a personal friend with whom I worked many times during my 36 years in the Senate. He and I were privileged to be part of the bipartisan Congressional team that produced the first balanced federal budget in 40 years.

Unfortunately, today, balanced budgets look like impossibilities unless we work in a bipartisan manner to fundamentally alter America's fiscal path. This symposium was the first of my efforts in the private sector to inform Americans of the dangers and challenges ahead. I thank the Bipartisan Policy Center for sponsoring this event and for its concern over this growing national crisis.

Pete V. Domenici
Former U.S. Senator and Chairman
of the U.S. Senate Budget Committee
Senior Fellow, Bipartisan Policy Center

Senator Pete Domenici

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Senator Pete Domenici was Chairman or Ranking Member of the U.S. Senate Budget Committee longer than any other Senator in history. Under his leadership, federal budgets were balanced for three consecutive years—the first time such balance had been achieved in four decades. What follows are excerpts from Senator Domenici's remarks at the Bipartisan Policy Center's May 2009 symposium on federal debt and deficits.

Unprecedented Federal Debt

"The topic of this symposium—unprecedented federal debt and its dangers to the nation's future—is the single greatest economic threat to America. Without dramatic changes in fiscal policy, America will find itself far weaker in the world, economically and strategically. We cannot continue on the present path of deficits and debt.

"When we balanced the budget for a brief period in the 1990s, we worked closely with President Clinton and his team, and with Republicans and Democrats in the House and Senate. We would never have achieved those balanced budgets without real compromise on strongly-held views on all sides.

"Now, a decade later, we face truly daunting debt forecasts. These forecasts come in an economic world far more chaotic than the one a year ago.

"My review of budget projections by the Congressional Budget Office reveals two major themes: first, unprecedented deficits and debts will constrain both fiscal and public policy as seldom before in our history; and, second, America must for the first time in its modern history, begin to wonder who will buy its massive projected sovereign debt and at what interest costs.

"We cannot continue on the present path of deficits and debt."

"Ominously, at a recent international conference, Chinese Prime Minister Wen Jiabao was quoted in the *Wall Street Journal*, saying the financial crisis was 'attributable to inappropriate macroeconomic policies of some economies and their unsustainable model of development characterized by prolonged low savings and high consumption; excessive expansion of financial institutions in blind pursuit of profit and other excesses.'

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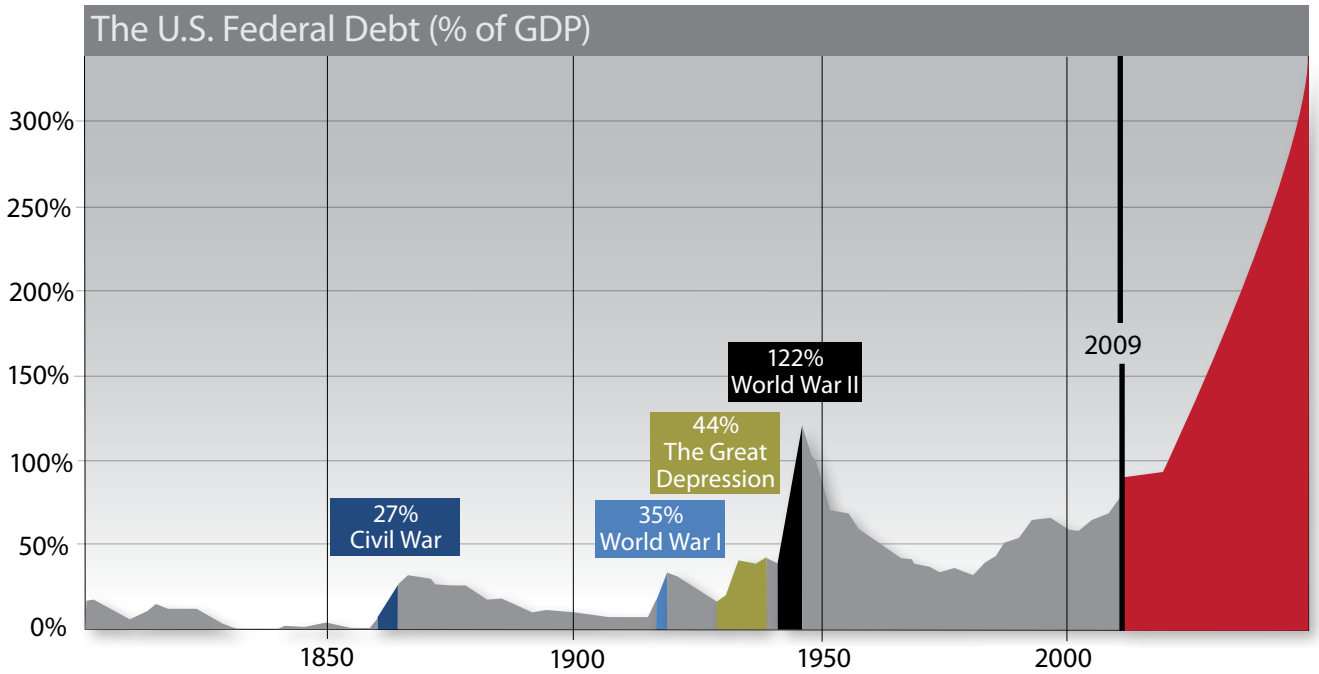

Sources: PGPF compilation based on Treasury, Institute for the Measurement of Worth, Bureau of Economic Analysis, Office of Management and Budget, Government Accountability Office, Congressional Budget Office

U.S. House Majority Leader Steny Hoyer

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U.S. House Majority Leader Steny Hoyer (D-MD) has served Maryland in Congress longer than any other person and is the highest ranking Member of Congress in Maryland's history. He was a key member of the bipartisan House and Senate congressional team that produced the last federal balanced budget in FY1998.

Putting Our Fiscal House In Order

"If I were to guess the single most lasting lesson of our economic crisis, and if I were to spell it out in just five words, I would say: this is what debt does.

"The recklessness we have seen from so many consumers, and from Wall Street, found an echo in the recklessness of the federal government. For years, our government has lived far beyond its means. What we are facing is not just an accounting of the issues, but a moral issue.

"I come here today with a good deal of optimism, because never in recent memory has the American public been so focused on the danger of debt…as a result, we have a very short window of time in which to act.

"The bipartisan trust we need for compromise has been sorely damaged. And both sides are guilty—Democrats for using Social Security as the 'third rail' for political advantage, and Republicans for walking away from the table at the first mention of raising revenues. Neither side has been willing to put forward realistic, effective alternatives.

"The political challenges of Social Security, Medicare, and Medicaid are extraordinary. So I think it's very possible that finding a solution will demand an extraordinary process. Some Members of Congress have called for a Fiscal Future Commission which would propose solutions and send them to Congress for a vote. A Fiscal Future Commission would help protect that process from the political attacks that have derailed it in the past. This is also a function that could be handled by the President's Economic Recovery Advisory Board, chaired by Paul Volker.

> "For years, our government has lived far beyond its means."

"First, both parties must work together in good faith. Bipartisan compromise will build public confidence that the solutions we agree on are reasonable, and it will prevent either party from exploiting those solutions for political advantage. Quite simply, we have to understand one another's fears—Republican fears that

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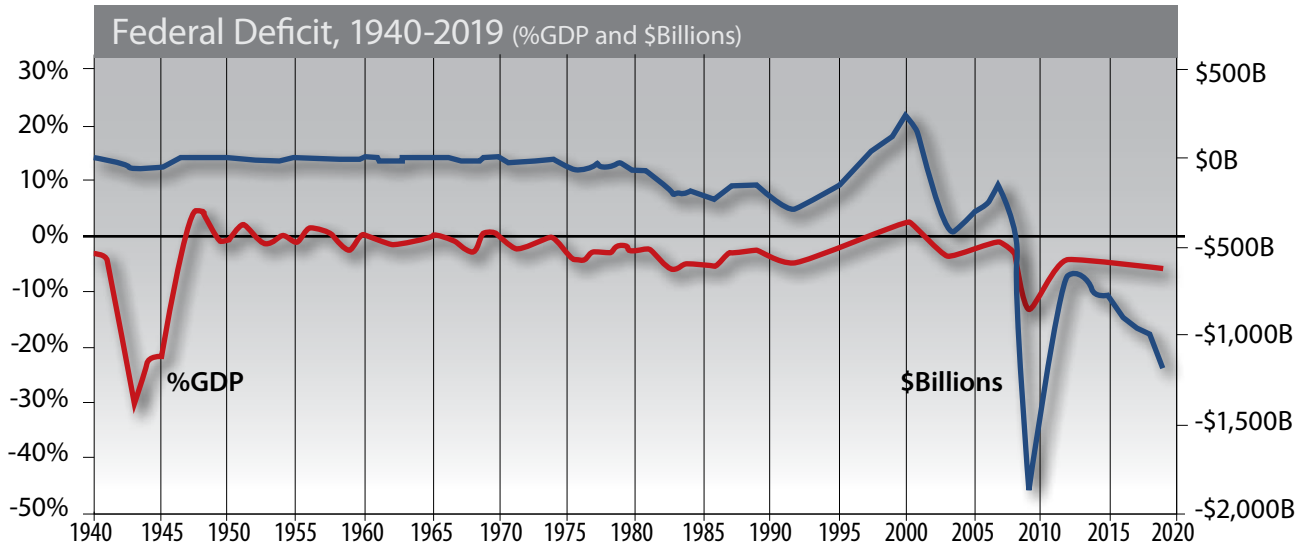

Source: CBO

David M. Walker

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David M. Walker is currently president and CEO of the Peter G. Peterson Foundation. He served as the seventh Comptroller General of the United States and head of the U.S. Government Accountability Office from 1998 to 2008. He has run organizations in all three major sectors of the U.S. economy, including three federal agencies and was appointed to Senate-confirmed positions under Presidents Ronald Reagan, George H. W. Bush, and Bill Clinton.

This Crisis Calls For a Grand Budget Bargain

"I want to talk to you about the structural fiscal problem, not the short term problem, not the long range problem. The long range is here now.

"The first structural issue is the composition of the federal budget. In the last 40 years, the composition of the federal budget has changed dramatically. It's gone from being dominated by defense, 46 percent in 1968, down to 21 percent in 2008, including Iraq and Afghanistan costs. There has been a significant increase in social insurance programs, in particular Medicare and Medicaid, which have gone from 4 percent up to 20 percent of the budget. And, back in 1968 we were paying 6 percent of the federal budget as interest on the public debt and that will increase.

"When Congress came to town in 1968, it got to decide on how two-thirds of the budget would be allocated. That was down to only 40 percent last year. Stated differently, 61 percent of the federal budget last year was on autopilot…if you look at the roles the Founding Fathers envisioned for the Federal government, (all of those roles) defense, foreign policy, federal judicial system, treasury functions, postal, etc., is only 39 percent of the budget.

"Tomorrow's taxpayers will get the bill."

"If you look at the total explicit liabilities, debt held by the public, military and civilian pensions, retiree health care, and others—we went from $6.9 trillion to $12.2 trillion in eight years. But, if you look at the things that are off the balance sheet—they are very real, but they are off the official balance sheet—you will find that when you consider Social Security and the three Medicare programs, there are total liabilities and promises that went from $20.4 trillion to $56.4 trillion in just eight years.

"Today taxpayers benefit from low-tax, high-spend policies. Tomorrow's taxpayers will get the bill. The American people are typically ahead of their elected officials. What we found in our March poll is that

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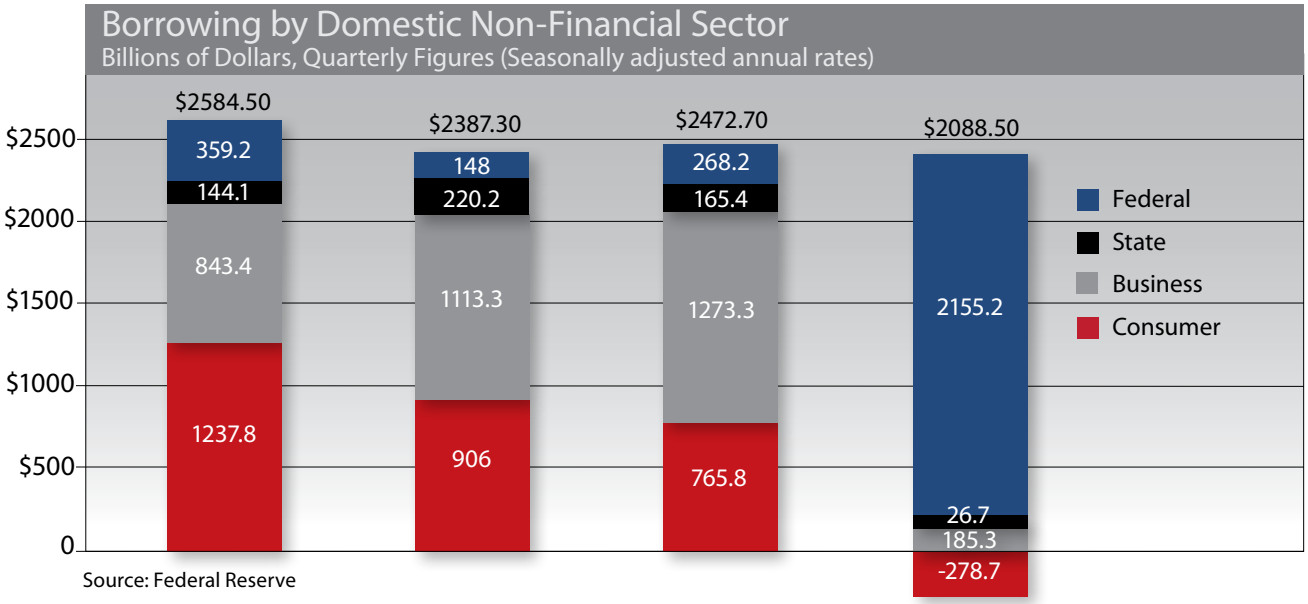

Source: Federal Reserve

G. William Hoagland

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G. William Hoagland is Vice President for Public Policy at CIGNA Corporation. For 25 years, Hoagland was a senior staffer in the U.S. Senate. He was Staff Director of the Senate Budget Committee from 1986 to 2003, and Director of Budget and Appropriations for Senate Majority Leader Bill Frist until 2006.

Even the Numbers Understate the Problem

"As a budgeter, I am going to try to make four points here today.

"Number one, the rate of debt accumulation today is of concern and untimely give government's rapidly increasing need to redeem Social Security and Medicare from bankruptcy.

"Number two, economic forecasts particularly in uncertain times like these are inherently problematic, but the fiscal trend line today is discouraging regardless of the economic forecast used.

"Number three, overall demand for domestic non-financial debt has weakened, allowing interest payments on the national debt to be manageable in the near term, but that is about to change for the worse.

"Finally, number four, foreign ownership of our public debt has increased and increasing public debt is correlated with the depreciating dollar.

"The budget blueprint adopted by Congress last week lays out a fiscal path for the next five years that shows the annual federal deficit this year of about $1.7 trillion, 41 percent of GDP and rising to 70 percent of GDP by FY2013. CBO estimates that the President's 10-year budget plan will lead to debt as a share of the economy growing to well over 82 percent.

"And interest on the public debt will grow from about $170 billion today to nearly $400 billion in four years, an unprecedented annual rate of growth of 21 percent per year.

> "We know today that 53 percent of all our outstanding U.S. Treasury securities are held by foreign investors."

"U.S. debt has been increasingly purchased by foreign investors, both central governments and individual investors. We know today that 53 percent of all our outstanding U.S. Treasury securities are held by foreign investors. And from 2001 until June, 2008, 78 percent of all Treasury securities issued had foreign purchasers.

"When public debt is held primarily by domestic investors, interest payments on that debt essentially are

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Congressional Budget Totals: FY 2008 – 2013
(In Billions of Dollars—% of GDP)

	2008	2009	2010	2011	2012	2013	% Δ annual 2008-2013
Receipts	2,524	2,186	2,322	2,624	2,856	3,057	+ 3.9%
Spending	2,983	3,879	3,555	3,541	3,476	3,639	+ 4.1%
Deficits	459	1,693	1,233	916	620	581	NA
% of GDP	3.2%	12.0%	8.5%	6.1%	3.9%	3.5%	NA
Public Debt	5,803	7,723	8,778	9,683	10,345	10,931	+ 13.5%
% of GDP	41%	55%	61%	64%	66%	66%	
Debt Subject to Limit	9,986	12,016	13,233	14,349	15,277	16,160	+ 10.1%
% of GDP	70%	85%	92%	95%	97%	98%	

Source: PGPF analysis of Office of Management and Budget data.

Robert D. Reischauer

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Robert D. Reischauer is President of the Urban Institute. He has served as Director and Deputy Director of the Congressional Budget Office, as a Senior Fellow at the Brookings Institution and as Vice Chair of the Medicare Payment Advisory Commission from 2001 until 2009. He received his Ph.D. from Columbia University and has written extensively on social welfare issues, budget policy, Medicare and Medicaid.

Exploding Debt, the Social Safety Net and Social Investment

"These gatherings tend to be rather gloomy. And, when I was thinking about what I might say last night, I came across a chart that I used eight years ago that might offer a bit of gallows humor to the group.

"At that time, we were enjoying a four-year period of budget surpluses: fiscal 1998 through 2001. And, during two of those four years, we enjoyed on-budget surpluses. One has to go all the way back to the 1920-1930 periods to find four back-to-back surpluses—we really thought we had entered the promised land.

"A lively debate was then taking place: how would the Fed conduct monetary policy once we had paid off the national debt? And CBO produced a chart that indicated that if we devoted all our surpluses to paying off the national debt, we would have paid it off by now.

"Well, the best economic minds in the country debated this monetary policy issue and came to the conclusion that it really wouldn't be a problem, that the Fed could conduct monetary policy by buying and selling Fannie Mae, Freddie Mac, and GMAC-type paper.

"Well, the economists were half right. We haven't paid off the national debt, but we do find that monetary policy is being conducted by buying Freddie, Fannie, GMAC and those kinds of debts.

"As you know, we are not paying down federal debt. In fact, we're entering an era of explosive growth of that debt.

> "We're entering an era of explosive growth of that debt."

"And, it's my guess as we play out the next decade, we're very likely to see divisive budget battles unless we begin to address the problem sooner rather than later. And in those budget battles, social consumption activity may be pitted against social investment programs. If that is the case, it is likely that social consumption will come out on top.

"What do I mean by these terms? By social consumption I'm referring to various programs that help sustain a marginally decent lifestyle for vulnerable populations in difficult times. Things like Social Security and disability, SSI, and of Medicare/Medicaid, unemployment compensation and so on. For the most

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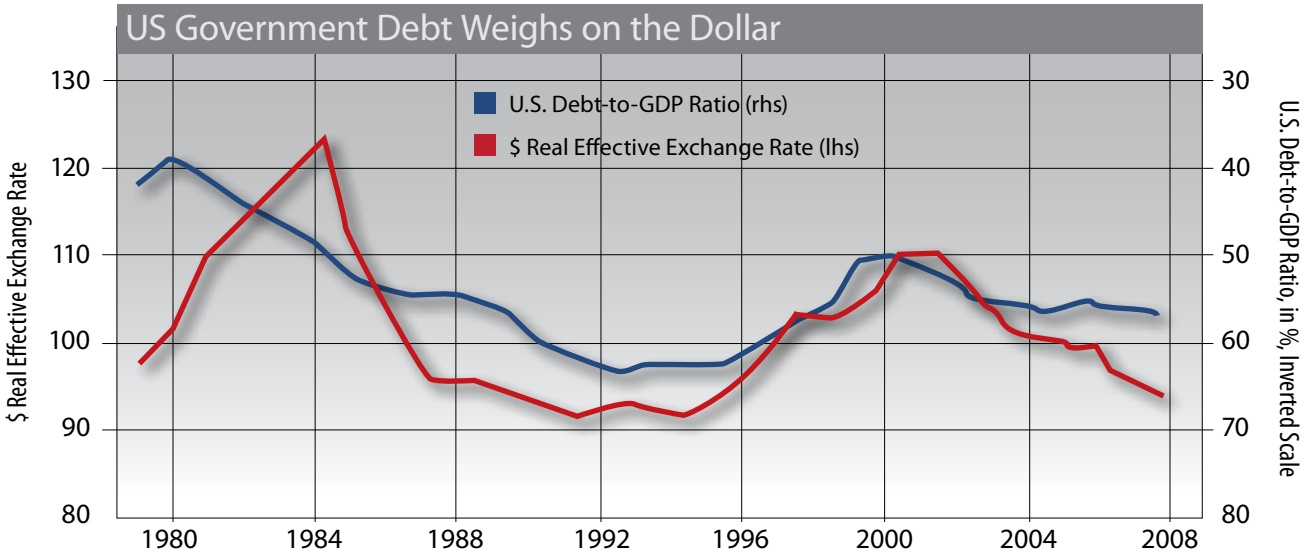

Source: Thomson Financial, UBS WMR

C. Fred Bergsten

greggibson.com

C. Fred Bergsten is Director of the Peterson Institute for International Economics. Previously, he served as Assistant Secretary for International Affairs at the U.S. Department of Treasury, Assistant for International Economic Affairs to Dr. Henry Kissinger at the National Security Council, and was called "one of the ten people who can change your life" by *USAToday*. He is the author or editor of 40 books.

The Long Term Economic Position of the United States

"We are releasing a new study today on the long-term international economic position of the United States. What it suggests is that unless we bring our fiscal internal balances under control, we will face external imbalances that are clearly unsustainable and out of control. They could bring enormous peril to the country, whether in fact foreigners are willing to finance them or not, although the high probably is that they will be willing to do so.

"The external economic position of the United States is already unsustainable."

"In some senses, the external economic position of the United States is already unsustainable. Our net foreign debt at the end of last year had already risen to $5 trillion, up about $2 trillion just in the year 2008 alone. That is already approaching the conventionally accepted danger threshold of about 40 percent of GDP.

"The record of economic history, rich countries, poor countries alike, is that when your net foreign debt gets to about 40 percent of your GDP, adjustment of your external position is forced even by market or by policy. It's going to be required, you're going to have to do something about it. We're getting very close to those numbers. As I say, our debt jumped by $2 trillion last year alone, a combination of our large current account deficits about half a trillion dollars plus some changes in the evaluation of foreign assets and liabilities.

"But in one sense, that number of $5 trillion of net foreign debt severely understates our vulnerability to external instability. The U.S. is, of course, the key currency country and dollars are held widely around the world. And gross foreign dollar holdings now approximate $20 trillion.

"The reason the gross number is probably more important than the net number is because most of our foreign assets held by American citizens are privately held: IBM's investments in Europe and the like. Those assets are not, to put it mildly, readily available to the U.S. government if there were a crisis.

"If it were a foreign run on the dollar, the number to focus on is not the net debt of $5 trillion but the gross debt of $20 trillion.

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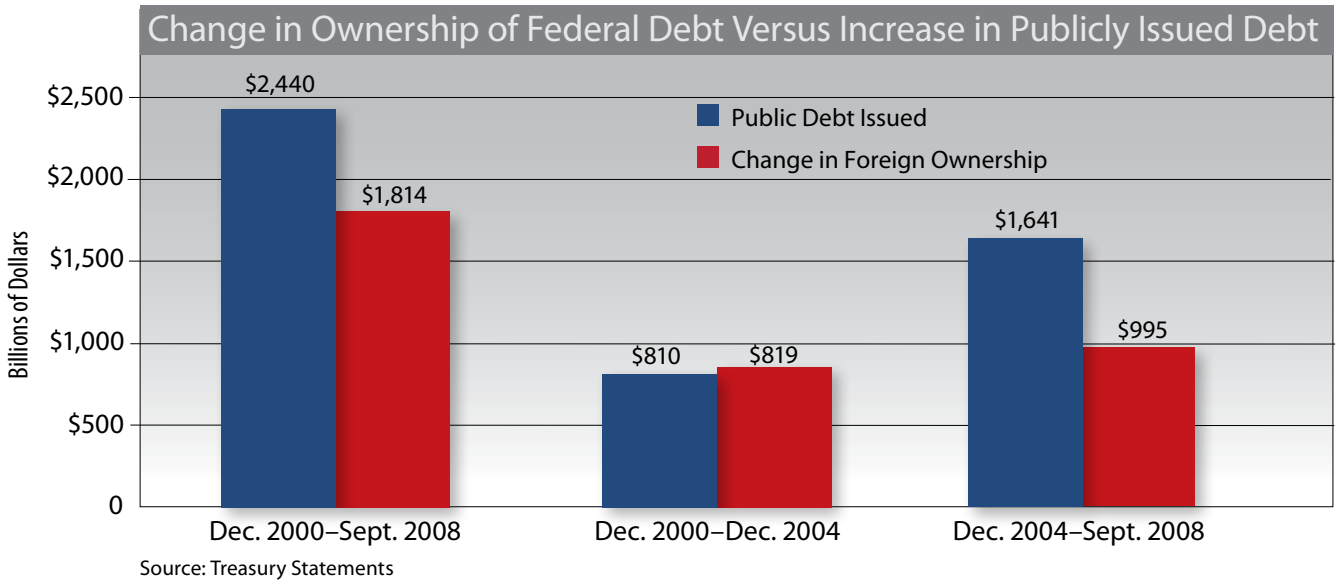


Source: Treasury Statements

Douglas Holtz-Eakin

greggibson.com

Douglas Holtz-Eakin is President of DHE Consulting, LLC. He served most recently as Director of Domestic and Economic Policy for Senator John McCain's presidential campaign. Holtz-Eakin has served as Director of the Congressional Budget Office, Chief Economist for the President's Council of Economic Advisors and held the Paul A. Volcker Chair in International Economics at the Council on Foreign Relations.

Neither Growth Nor Taxes Alone Will Solve This

"Senator Domenici asked me to fill in pieces on revenues and growth. In this respect I think there are a couple of obvious points.

"First, we will not grow our way out of this problem. Under CBO scoring of the President's budget, the debt/GDP ratio rises to over 82 percent by the end of the budget window and would keep rising after that. The underlying rate of GDP growth would have to double—to over 8 percent—to keep the debt/GDP ratio at its 2010 level of 64 percent.

"The U.S. must quickly reverse course and put its fiscal house in order."

"Second, we will not tax our way out of this problem. Over the next several decades, Social Security spending will rise to roughly 7 percent of GDP and Medicare and Medicaid will grow to at least 12 percent. These two programs, then, will be nearly as large (20 percent of GDP) as the entire federal budget traditionally has been. A pure tax approach to balancing the budget and/or reducing debt would require federal taxes that are 50 to 100 percent higher than in the past. The damage to the U.S. economy would be catastrophic.

"I think we can summarize the mess in which we find ourselves this way:

- Under the President's budget or the Congressional budget resolution, the United States is on an unsustainable trajectory of debt issuance. We are putting ourselves in the financial position of undergraduates who get a new Citibank card to make the payment on the interest on the Chase card. Worse, there is no Mom or Dad to bail us out—it's Mom and Dad busily sticking it to the kids.
- Recent policy initiatives have layered additional debt issuance on top of the fundamental problem posed by entitlement programs that beg for reforms.
- The debt issuance and interest obligations will limit our ability to address other policy objectives.
- We are empowering our enemies to say 'no' via international capital markets.

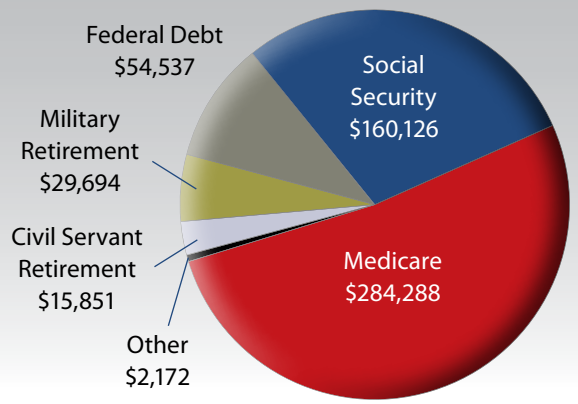
"The bottom line: it is more likely that the deficits will be bigger and the debt greater and the unsustainable trajectory steeper than depicted in the Obama budget.

"To summarize: it is a daunting outlook. The U.S. must quickly reverse course and put its fiscal house in order. This will necessarily require policies that support the growth essential to generating additional resources. Real restraint on federal spending is an imperative. And the tax systems will need an overhaul to provide the revenue needs of the federal government."

What We Owe

Federal obligations for benefit programs and the national debt soared $6.8 trillion in 2008 to $63.8 trillion.

Cost per Household = $546,668



Source: USA Today

Britain Warned On Credit Rating

S&P Move Reflects Concern Over Debt

By Annys Shin, Washington Post, May 22, 2009

A leading credit rating agency cut its outlook for Britain yesterday, moving the country a step closer to a downgrade and highlighting the vulnerability of the United States' own top-notch rating.

In cutting its outlook for Britain's sovereign rating from stable to negative for the first time, Standard & Poor's cited debt levels approaching the size of the nation's gross domestic product. While S&P reaffirmed Britain's actual long-term credit rating at AAA, its statement was effectively a warning about massive government spending.

Soaring budget deficits in Britain and the United States have set off alarm bells at credit rating agencies such as S&P, Moody's Investors Service and Fitch, which assign grades to different types of debt. The grades—ranging from C, or junk-bond status, to triple-A—gauge the risk that a company or a country might default on its debts. A nation's rating is known as a sovereign rating.

A sovereign rating downgrade can undermine investor confidence at a time when many governments need investors to buy their debt. That could make it more costly to finance bank bailouts or stimulus spending.

The lowering of the outlook for Britain serves as a cautionary note for the United States, analysts said, because the federal government is also running record deficits as it tries to revive the economy.

"Contracting economic activity does really adverse things to government revenues, and so unless you're a magician your deficits get worse," said Carmen Reinhart, a University of Maryland economist. "And if your deficits get worse, you finance it with debt. . . . Debt leads to downgrades."

Since the recession began in December 2007, the rating agencies have warned of potential threats to the U.S. rating, including the government bailout of mortgage finance companies Fannie Mae and Freddie Mac. In September, after the first bailout of American International Group, S&P Managing Director John Chambers likened the U.S. triple-A rating to a live lobster in a pot of water with a fast-rising temperature. He told Reuters: "There's no God-given gift of an 'AAA' rating, and the U.S. has to earn it like everyone else."

A growing number of countries have had their sovereign ratings tarnished. Since January, Ireland lost its AAA rating with S&P, India's credit outlook was downgraded to negative from stable and Latvia's debt is at junk status. Iceland lost its triple-A rating last year, and Spain, Portugal and Greece have had their ratings taken down a notch.

The United States has stayed out of that club, and actually had its rating reaffirmed by S&P in January. Many analysts argue that the odds of a downgrade are remote for several reasons. The U.S. government can print money to finance debt. The dollar is a global reserve currency, which helps sustain demand for U.S. debt securities. And according to S&P, even in a worst-case scenario, the size of the government's debt in relation to the GDP would still be in line with that of triple-A countries such as Germany and France.

To stave off a downgrade, leaders on both sides of the Atlantic have worked hard to convince the rating agencies of their commitment to fiscal responsibility.

The Obama administration and Federal Reserve are attempting to walk a fine line on spending. To combat the recession, they created a number of programs with multibillion-dollar price tags. But as the downturn has shown signs of slowing, they have started to emphasize their commitment to deficit busting.

"We must get our fiscal house in order or risk having government borrowing crowd out productive private investment," Treasury Secretary Timothy F. Geithner said at a congressional hearing yesterday. "Treasury and the White House will work with Congress to make the tax changes that are necessary to reduce deficits and do so in a manner that is fair to all Americans."

Leap in U.S. debt saddles taxpayers

Each household 12% deeper in red

By Dennis Cauchon, USA TODAY, May 19, 2009

Taxpayers are on the hook for an extra $55,000 a household to cover rising federal commitments made just in the past year for retirement benefits, the national debt and other government promises, a USA TODAY analysis shows.

The 12% rise in red ink in 2008 stems from an explosion of federal borrowing during the recession, plus an aging population driving up the costs of Medicare and Social Security.

That's the biggest leap in the long-term burden on taxpayers since a Medicare prescription drug benefit was added in 2003.

The latest increase raises federal obligations to a record $546,668 per household in 2008, according to the USA TODAY analysis. That's quadruple what the average U.S. household owes for all mortgages, car loans, credit cards and other debt combined.

"We have a huge implicit mortgage on every household in America except, unlike a real mortgage, it's not backed up by a house," says David Walker, former U.S. comptroller general, the government's top auditor.

USA TODAY used federal data to compute all government liabilities, from Treasury bonds to Medicare to military pensions.

Bottom line: The government took on $6.8 trillion in new obligations in 2008, pushing the total owed to a record $63.8 trillion.

The numbers measure what's needed today set aside in a lump sum, earning interest to pay benefits that won't be covered by future taxes.

Congress can reduce or increase the burden by changing laws that determine taxes and benefits for programs such as Medicare and Social Security.

Rep. Jim Cooper, D-Tenn., says exploding debt has focused attention on the government's financial challenges. "More and more, people are worried about our fiscal future," he says.

Key federal obligations:

• Social Security: It will grow by 1 million to 2 million beneficiaries a year from 2008 through 2032, up from 500,000 a year in the 1990s, its actuaries say. Average benefit: $12,089 in 2008.

• Medicare. More than 1 million a year will enroll starting in 2011 when the first Baby Boomer turns 65. Average 2008 benefit: $11,018.

• Retirement programs. Congress has not set aside money to pay military and civil servant pensions or health care for retirees. These unfunded obligations have increased an average of $300 billion a year since 2003 and now stand at $5.3 trillion.

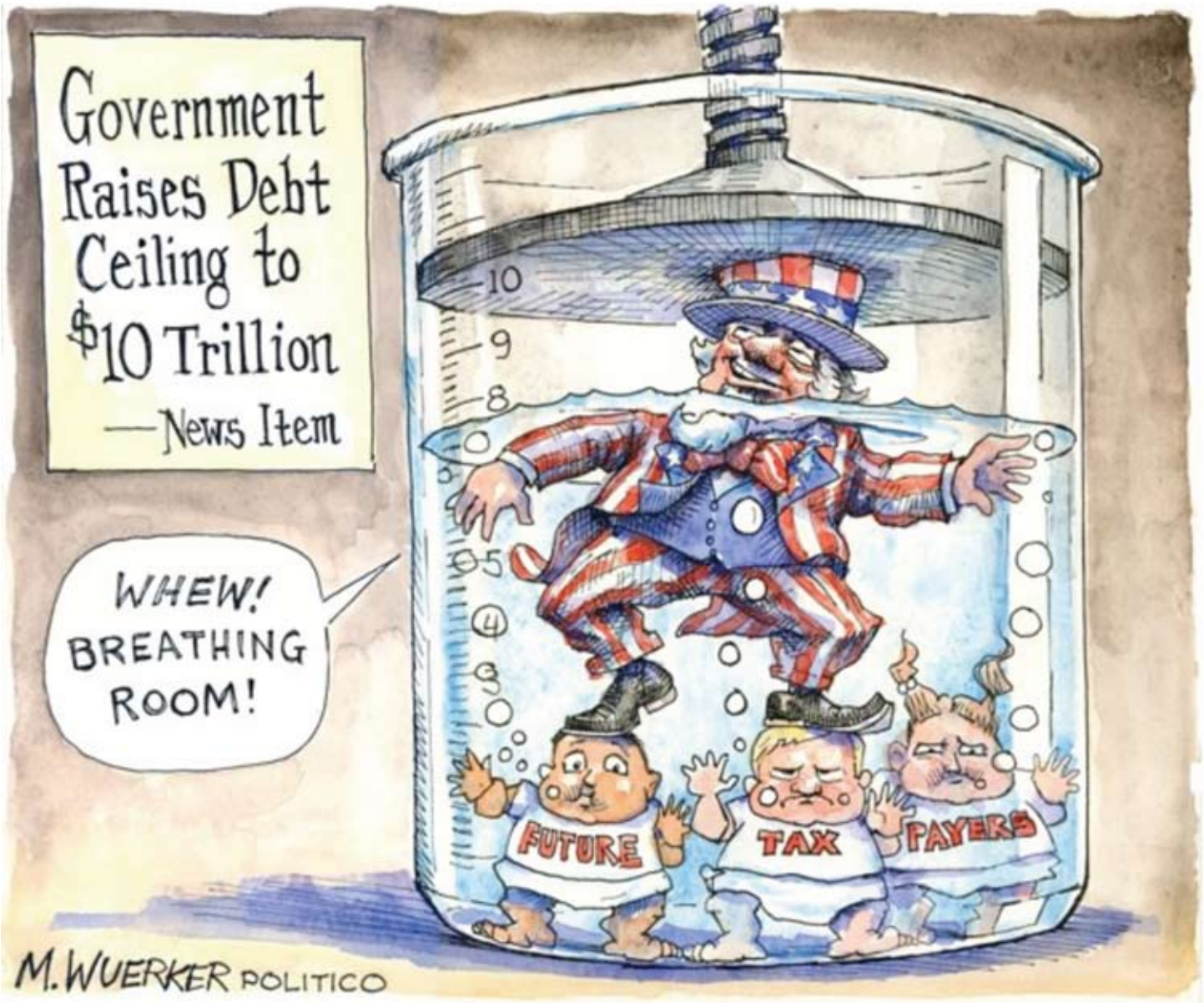
What Now?

The following is a summary of the recommendations regarding the debt and deficit crisis made at the May 2009 symposium entitled, *"Putting Our Fiscal House in Order: Unprecedented Federal Debt"* and hosted by the Bipartisan Policy Center:

- Create a commission, outside Congress, empowered to make recommendations on a global solution to deficits, including tax reforms, entitlement changes, and new ways of measuring and controlling government finances, and compel Congressional action on such recommendations;
- Re-enact true statutory budget control (like a firm PAYGO regime) that addresses discretionary and mandatory spending as well as tax preferences;
- Pursue comprehensive tax reform that makes the system more streamlined, understandable, equitable and competitive while also generating adequate revenues;
- Immediately reform Medicare and Social Security in order to bring solvency to those systems long-term;
- Recognize the international dangers America runs as it transfers more and more of its wealth to other countries that own and, we hope, will continue to buy our sovereign debt issuance.

"In particular, over the longer term, achieving fiscal sustainability—defined, for example, as a situation in which the ratios of government debt and interest payments to GDP are stable or declining and tax rates are not so high as to impede economic growth—requires that spending and deficits be well controlled."

Federal Reserve Board Chairman Benjamin Bernanke
June 3, 2009 testimony to the U.S. House Budget Committee



Courtesy of Matt Wuerker, POLITICO

Domenici, *continued from page 1*

"That came from the Prime Minister of a nation that now holds three-quarters of a trillion dollars of American debt and to which we will look to in the future as a purchaser of even more of our debt. How long can that continue?

"To Dave Walker, Bob Reischauer, Doug Holtz-Eakin, Fred Bergsten and my long-time friend, Bill Hoagland: great thanks to you for helping me with this symposium. No group anywhere could be put together that has greater knowledge and experience in all phases of federal fiscal policy than this one."

Hoyer, *continued from page 3*

Democrats will merely raise revenues and then spend them on new entitlements, and Democratic fears that reform will undermine the security of those in need and weaken support for popular programs. Those fears are understandable—but they should be outweighed by the fear of what will happen if we fail, if our debts overwhelm us, and if the fiscal meltdown comes. Republicans fear that taxes will go through the roof and think that families and small businesses will suffer. Democrats fear that the programs we value will be slashed, and that those we most want to protect—the weakest, the least powerful—will suffer the most. Compromising now is the only way out of that worst-case scenario.

"But that shared purpose isn't enough. Second, and as importantly, we need to engage the public. Our political system is built to encourage easy decisions. If the incentives are going to change, the voters have to be the ones to change them. So to those of us who understand the danger clearly: Let us explain the stakes. Let's make it clear to anyone who will listen that fiscal issues are moral issues that the kind of lives our children will lead are at stake. And let us seize this rare and precious moment in time."

Walker, *continued from page 5*

the American people were more concerned about the growing budget deficit and national debt than jobs being shipped overseas, than hostile nations developing nuclear weapons, than schools not providing skills to compete in a global economy.

"President Obama was correct in January when he said that we need to achieve a grand bargain on his watch. At a minimum that would mean budget controls, Social Security, taxes, health care reform, Medicare, Medicaid and tax preferences, too. A grand bargain means that everything is on the table. It means interactivity. It means a comprehensive and integrated approach. You cannot get there without some extraordinary process.

"That's why Members of Congress have sponsored legislation like that of Sen. Lieberman and Sen. Voinovich to create the Save America's Future Economy Commission…to make a package of recommendations on those areas and others that will receive a guarantee vote in the Congress."

Hoagland, *continued from page 7*

redistribution of incomes and assets within the domestic economy. However, as our debt increasingly is held by foreign investors, then payments on interest and principle involve actual costs to the domestic economy, rather than re-distribution within the economy.

"And, adding to the bad news, low interest rates will not continue, particularly as the economy improves and consumer and business borrowing returns to historical levels. Interest service costs on the accumulated public debt will expand as interest rates return to their historical average, projected conservatively to double from 3 percent today for the 10-year to 6 percent—and this does not include potential Federal Reserve policies to remove the extensive liquidity it has pumped into the economy this past year.

"Using the statutory debt limit as a proxy for all the unfunded liabilities the government has—including Social Security and the HI Trust Funds balances—this gross debt will increase nearly three times faster than our economy will during the next five years. And, worse yet, this is before the onslaught of retirements from the likes of me and 77 million others like me, coupled with the need for the Treasury to redeem its internal debt owed to Social Security, which will go negative within 10 years.

"I think it's appropriate for me to conclude with a quote. I still carry it around with me, along with a copy of the Constitution. 'Given the centrality in our revolutionary origins of the precept that there should be no taxation without representation, it seems especially fitting in principle that we seek somehow to tie our hands so that we cannot spend our children's legacy.' Some long-ago Founding Father? Some right-wing conservative? No, Lawrence Tribe, Harvard Law School, June, 1992."

Reischauer, *continued from page 9*

part, these programs are entitlements and it takes legislative action to change them. Our political system is one in which it's easier to stop things from happening than to make change happen. And so the status quo always has the upper hand.

"There are other reasons why these programs, most of which are entitlements are likely to come out on top. One, of course, is that they have powerful constituencies behind them. And this is a chart that shows the distribution—the change in the distribution of the voting—likely voters—through time. And if you go out, even as soon as 2015, 2018, you will find that over half of the likely voters given a past demographic engagement in the election are going to be 55 and over, and their concerns are going to be about preserving these social consumption program as inflation rises and interest rates increase.

"Social investment programs, on the other hand, are directed more at future generations, they are education, training, child nutrition, child health, and so on. And many of these programs are discretionary in nature, must be reauthorized, and are much more vulnerable to change should severe budget constraints be placed on this country.

"And so, my bottom line here is that exploding debt threatens to skew our spending priorities in ways that are likely to undermine the long-term prospects for this country. We need to begin to bring down deficits, not right now but certainly within a couple of years, and part of that adjustment must be borne by the social consumption programs. The time to start this is now because these programs can only be changed prospectively and only with a lag and in a very gradual kind of way."

Bergsten, *continued from page 11*

"Now we know that of the $20 trillion, over $5 trillion is held by foreign governments: over a trillion by China, a trillion or so by the oil exporters, a trillion roughly by Japan. Some of those countries do not, to put it mildly, always have our best interest at heart and need not always be friendly, and so the vulnerabilities that were mentioned here today clearly already exists and to some suggest that we already have a deep problem.

"In fact, what's happened already this decade suggests that our external position is unsustainable. The change rate of the dollar dropped by over 25 percent through this decade. It's reversed a bit over the last year because of the crisis and the flight to safe haven in Treasury assets in the midst of the global financial crisis, but that's almost certainly a temporary phenomenon in light of what I will be saying later.

"And the numbers, as I indicate, are truly staggering. By 2015—and again, the thresholds to keep in mind, the kind of sustainable levels based on economic history and best judgments of a dozen scores, hundreds of scholars who have analyzed these issues including at my institute is that you can get away with current account deficits of three or four percent of GDP. You can get away with a net foreign debt of 40 percent of GDP. But if you go beyond those numbers, you're probably in pretty big trouble.

"Here, what the projections indicate and I would refer you to the table included in the press release that's in your material circulated for the conference.

"Already by 2015, a mere five-years out, we would be running current account deficits again above 5 percent of GDP and our net foreign debt would have exceeded the threshold of 40 percent.

"By 2020—a mere ten years out, the current account deficits would be hitting 7 to 8 percent of GDP, net foreign debt would be something like 65 percent of the economy.

"By 2020, the current account deficit gets into double digits exceeding 10 percent of GDP and that carries the foreign debt close to 100 percent equaling our GDP.

"And if you carry it out all the way to 2030, on these CBO alternative projections of where the budget deficit is going, it would take you to something like 15 percent or even more current account deficits—that's running incidentally at $6 trillion a year, 10 times what it was at the recent peak—and our net foreign debt to 140 percent of GDP, three to four times any reasonable estimate of what is a sustainable level.

"In short, these numbers are totally off the charts in terms of not only what a poor, developing emerging third world country might run and get into trouble, but what any high-income industrial mature society like the United States might have contemplated in the past."

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"The long-term deficit and debt that we have accumulated is unsustainable. We can't keep on just borrowing from China, or borrowing from other countries…So we are going to have to deal with our long-term debt. As I said before, the biggest thing that we can do on that front is to deal with entitlements."

President Barack Obama
Rio Rancho, New Mexico
May 14, 2009