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Forum for the Future of Higher Education**

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Approaches to Deficit Reduction

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MS. RIVLIN: Thank you.

We're facing a really serious budget crisis. Now people like me have been saying that for a long time, and there is a wolf-wolf problem here. And the really difficult problem is to say *now* it's really, really a crisis.

The Deficit Problem

If you look ahead at the projections, anybody's projections, CBO or anyone else, of the federal budget, it's very, very clear that on the course we're on, even as the economy recovers, federal spending will rise a lot faster than federal revenues. And that's because we've made promises under Medicare and Medicaid, and to a lesser extent Social Security, that, unless we change something, will mean that the cost of those programs rise faster than the economy is growing -- and tax revenues will only rise about as fast as the economy grows.

That's not new news. You all knew that. You knew that 10 years ago. You probably knew that 20 years ago. So what's the new news? Well, one is that this serious problem is a lot closer than it used to be. We used to think of the baby boom generation's retirement as

sometime in the future, but now it's happening. And medical care prices, which drive a lot of this, are going up faster and have been going up faster than the prices of everything else for a long time. And there's no sign of that abating.

But what has happened in the last few years is what you have just been talking about: It is the much higher level of United States debt, which is a result of the recession, the crisis, and the mitigating actions that were taken by everybody. So that whereas a few years ago you might have said, we know we've got this long-term thing coming at us, but we're not a country with a high debt relative to our strong economy and so we'll have time to fix this. That's no longer true.

We now have a debt that, instead of a ratio of around 40 percent of GDP a very few years ago, just three or four years, in fact, is now over 60 percent of GDP. And it's moving up on any projections very, very rapidly to dangerous levels.

We're seeing a vivid demonstration in Europe of what the dangers can be of a sovereign debt crisis; that it hits very fast, and interest rates can go up very rapidly. And it was nice when it was just Greece to say, well, we're not Greece. We're very different. Well, and we're very different from Ireland, and we're very different from Portugal. And we're very different from Spain, and we're not that different from the UK. And now it's beginning to look like this is something that could hit us.

So it's a very, very serious situation, and if we don't do something to get our budget on a more sustainable track, there certainly is a possibility that we face a

sovereign debt crisis in this country in not too long. How long? Nobody knows. And the answer to the question, well, exactly what might happen and when might it happen? Nobody knows the answer to that, except we better take out some insurance lest it be a pretty proximate event.

And the one thing we do know about sovereign debt crises is once they happen, they're very hard to stop, and the downward trajectory is fast and quick.

But knowing that, as we have for a while, the political response has been, in the last election, outrage of a very unspecific sort. The last election focused everybody's attention on the fact that we have a very high deficit. It wasn't as good at focusing on the problem that I think is the real problem, that is, the trajectory over the next 5 to 10 years. And there was a lot of blaming of the President. If you were a Republican, you were saying it's all the President's fault, look at what's happened to the budget deficit in the last two years.

If you weren't a Republican, you would be saying, yeah, but George Bush was part of the problem, and he cut taxes and raised entitlement benefits. So it's not all Obama's fault. And this is not very helpful at all on either side.

Debt Reduction Commissions

The question is, what do we do now? I've been privileged in the last few months, and I do consider it a privilege, to have served on two debt reduction commissions. The first, appointed by the President, was an offshoot of the Conrad-Gregg proposal, which was to set up

a congressional commission composed of members of Congress who would work on a deficit reduction/debt control plan and bring it back to the Congress just after the election. That proposal didn't get the needed 60 votes in the Senate, and so the President decided, okay, I will do something because he realized how much the political system was going to need some kind of blueprint. So he appointed by executive order the commission chaired by Erskine Bowles and Alan Simpson that included 12 members of the Congress and the Senate and also 6 public members, including Bowles and Simpson, of whom I was one.

And we worked very hard during the election period, and behind the scenes it was a remarkably collegial group, despite what the press may have said. But with an election going on out there, nobody could have serious negotiations. We had a lot of briefings and a lot of conversations about options, but until the election was over, there was no way we could actually have a negotiation because of the extreme danger that it would be used by one party against the other, which everybody knew.

So we had these civil conversations, and then when the election was over Simpson and Bowles put together a plan, which was their distillation of the conversations and some one-on-one or two-on-one discussions that they'd been having, and brought it to the commission, and we debated it. They revised the plan a bit, and brought it to the commission for a vote.

Sixty percent vote of the group voted to sign the plan, and yet the press dismissed it out of hand by saying it didn't get the 14 votes that would have been necessary to take it to the floor for a vote. I don't think anybody

in this room fell for that.

Taking it to the floor for a vote was never a realistic thing anyway. That was a vestige of the old Conrad-Gregg idea of having a Congress-only group. You can't write laws in a group of mixed members and non-members, and we never thought we were writing a law. We were writing a report.

And the fact that the people who were involved in discussing and writing this thing were actually all the important members of Congress from the point of view of the outcomes was what actually mattered. And not everybody signed it, but a remarkably diverse group of Senators did. They included Dick Durbin from Illinois, who is a strong liberal. They included Tom Coburn, who has become my favorite conservative: Dr. Tom Coburn from Oklahoma, who is a real conservative. It included Crapo. It included Gregg. It included Conrad. It didn't include Senator Baucus, and I think the only reason it didn't was he is chairman of the Finance Committee and he thinks that bills like this are written in his committee, which they are, and he wanted to keep his options open. So he didn't actually sign it -- but, anyway, a good group did.

And in the Senate, in any case, this nucleus of conservatives and liberals who realize we've got a real problem are, I think, pushing forward in various forms to get bipartisan action going. That's a lot less true in the House though.

Meanwhile, I also co-chaired with my friend Pete Dominici, former Senator from New Mexico, another group that had similar bipartisan representation, and that benefitted from the fortunate fact that none of us were

running for public office. So we didn't have to be quite as careful about what we said. We came up with a report, which we put out shortly before the President's group, for which we had a consensus, meaning the whole group backed the report as a whole, which is to say not everybody agreed with everything that was in it, but thought it was a good bipartisan compromise -- that's the essence of that sort of thing.

What these two groups proved, I think, is that you can get a group of Republicans and a group of Democrats who understand the issue and realize how catastrophic it would be if we don't address it. You can get such a group to coalesce around a plan of some sort.

And the other thing is proves is that such a group, whatever its composition, has got to come up with a plan that both cuts future spending -- especially the rate of growth of entitlements -- and increases future revenues, because if you don't do both you can't get there. It is clearly impossible to do it all on the spending side or all on the tax side.

So, both these groups did that: spread the pain of spending cuts fairly widely and included defense as well as domestic spending cuts; froze spending in dollar terms, that is: no inflation, no growth factor, no anything on discretionary spending, both domestic and defense, and presented entitlement reforms. And, I think most interestingly, proposed very drastic tax reform, because if you take this problem seriously, what you realize almost immediately is we've got to have more revenue but we have a terrible tax system -- it's inefficient, confusing, unpopular, et cetera, and this is the big opportunity to do

drastic tax reform, which would make the tax system fairer and simpler and raise more revenue into the bargain.

And so if you look at those two reports, you'll see all of those things reflected. They differ somewhat. I prefer the Domenici-Rivlin one, because I had more hand in drafting it, but also it recognized more clearly that we've got to get out of this recession at the same time that we deal with the longer-run deficit problem. It's not a choice. So what we put in the Domenici-Rivlin plan up front was a one-year payroll tax holiday on all payroll tax, and the President picked that up very quickly and put part of it in the tax compromise that passed in December 2010, but it's smaller. And the mix of spending cuts and revenue increases is, I think, more revenue and less spending cuts in Domenici-Rivlin than in the other plan. But basically these are similar kinds of plans.

The Deficit and Higher Education

Now, what's going to happen and how might it affect higher education? I don't know what's going to happen, but something has to, and I think there are two people now who will determine what happens. One is President Obama. He's got to take some leadership, get out front on this problem -- I think he will -- and make very clear in his budget message, that he understands the issue. The Administration is prepared to back some very unpopular things and to negotiate with the Congress.

Now, he shouldn't put his bottom line in the budget. He should put his opening offer, because this is going to be a negotiation with the Republicans. Bill

Clinton was very good at that when he dealt with a Republican Congress, which was six out of the eight years that he was President. He did a lot of negotiating, part of which got us not only to a balanced budget but to a surplus, using the veto threat, playing the House off against the Senate, all sorts of things. Whether Obama and Obama's team are as good at that, we'll see.

The other person who holds the key is John Boehner, and he's got to rein in the people who are saying well, we'll just take it all out of the spending side; we'll cut spending by \$100 billion in fiscal 11. But fiscal 11 is partly over. Doing that makes very little sense, but there certainly is an extreme group that wants very drastic action, all on the spending side, and which may not understand the consequences of either such drastic cuts in spending on the economy in the near term -- not to mention for the beneficiaries of those programs -- or the serious consequences of either closing down the government or not raising the debt ceiling. I don't think they're going to close down the government -- we lived through that in the Clinton Administration, and the Republican leadership of the Congress has not forgotten it; it was a disaster. They thought it would be popular with Republicans. It wasn't popular with anybody. So, I don't think they'll do that again.

But then there's the question of the debt ceiling. To go on funding the government, we've got to raise the debt ceiling, probably in April or May -- nobody's sure exactly when -- and if we don't do that, sooner or later -- not immediately -- the U.S. government defaults. And that has been, to most of us, an absolutely unthinkable thing.

Maybe not to the new members of the Tea Party Right. And so Boehner's job is to explain why it's important that we not default and at the same time get across that we have to solve this problem and we have to work it out with the President.

I think this will probably happen, but it'll play out in the next few months. How will it affect higher education? Not well. I mean, there's no cheer here. Even if some of the things that are in the two commissions' plans are done, that is, the sensible, non-crazy, bipartisan approach -- it's going to be very hard on higher education, as well as everything else. It will mean freezes in discretionary spending, or maybe cuts in discretionary spending below the 2011 level, whatever that is, we don't even know yet; and probably similar kinds of cuts in entitlement programs like Pell Grants and so forth. So, it's not going to be pretty.

Now, I personally have enormous sympathy with the argument that you will all make that you are strongly in favor of fiscal responsibility and balancing the budget, but higher education is different because it's an investment in the future of America and nothing could be more foolish than eating our seed core and cutting our investment in the growth of the economy, which is the business you're in. That's right. I agree with that. But everybody else can make that argument, too. The Defense Department is already making it. Bob Gates has been reasonable about some cuts. The defense establishment basically is saying nothing could be more foolish than to balance the budget by making ourselves less secure. The infrastructure folks have a similar argument. And of

course, all of the science and research community, of which you're a part but you're not the whole, will make that kind of argument.

There are going to be cuts, and they are going to be quite drastic, and I don't know how this will come out. But the thing to be arguing, I think, is not preservation of everything, but preservation of the most important things with a recognition that not everything can be preserved.

Let me stop there, because I talked too long.

Mr. Bosworth: Alice can take some questions.

Discussion

SPEAKER: A follow-up on your last point. I think everybody here believes that we have to rein things in. Higher education benefits from tax credits, from tax exemptions, all kinds of benefits from the Tax Code. We also have the R&D Budget, which has been very robust in recent years, particularly as a result of the stimulus, and that disproportionately comes to us. We've got our entitlements or quasi-entitlements that are terribly important. And, by the way, we really like our small programs that help one or another of us a lot. How do you bring higher education, like many other industries, to the table to recognize what has to be done, and how do we come together in our own camp to prioritize what's most important versus other things?

MS. RIVLIN: Well, the second question, I think, is not one I could help you with much, and it would

inevitably be a compromise anyway as a group. A diverse group of higher educators gets together, and some things are important to some of you and some things are important to others of you, and research universities are very different from small colleges, et cetera. So, I don't know how you do that except it'll be a balancing act.

On the larger question, though, I think the first thing is to get over denial, which is the easiest course, and some of my fellow economists are not helping. I would say Paul Krugman and Jamie Galbraith particularly are not helping, because they are basically saying there's no problem. Krugman isn't quite saying that; he's saying there is a problem but it's out there somewhere and meanwhile we've got to do the stimulus and get the economy on track and those awful deficit hawks are going to kill us.

I think that's really not right, and that Paul with his Nobel Prize is smart enough to keep two ideas in his head at once. The two ideas are yes, we've got to get out of this recession and we shouldn't cut spending too drastically or raise taxes right now, but it is important for the recovery to show the world that we have a responsible government that is taking this problem seriously. The consequences of not doing so are so much worse for everybody, including universities, than short-term pain right now. That's the first thing to get through.

On the tax side, I think it's a little easier on the spending side, because it really is true that if we got rid of all of these deductions, exemptions, et cetera, we could have a tax system with lower rates that raises more

money, and it's not obvious that higher education and all the other people that are favored by many of these things wouldn't be just as well off if that were true. But on the spending side, it really is difficult. I would be very strong about protecting the best of student aid -- which I think is the student aid directed toward low-income kids -- and the best of the research budget, which isn't every damned thing that's in it. Those are very hard decisions to make.

Yes.

SPEAKER: At the same time this is going on, some states are facing their own version of this issue -- Illinois and California, maybe Texas. If one of those succeeded in coming to a deal, how will that affect the federal discussion?

MS. RIVLIN: I see these going on rather separate tracks. That has been true up to now, though not entirely, and what I mean by that is I don't see the federal government in the next several years bailing out the states or localities. I don't think we'll have actual state defaults, but we're certainly going to have state cutbacks and tax increases. It's already happening. And a lot of those are going to affect higher education. And that's already happening. The really serious potentials for default I think are more at the local level as the states cut back their aid to the localities, but I don't think the feds are going to step in there. The states and the localities themselves are going to have to deal with it.

Now, it depends on how quickly you think the economy will turn. Things are getting a little better, and state revenues are beginning to come back up again. So,

maybe they can make it for another couple of years and then get back to what passes for normal. But there's going to be some pretty drastic cutbacks in the meantime.

Yes.

SPEAKER: Do you think health care reform will help reduce the deficit, or might it increase it?

MS. RIVLIN: Health care reform both raised potential spending in the form of the subsidies for low-income folks without insurance -- that's clearly a new entitlement - and it contained a lot of very different kinds of cost control measures, some that I think are hopeful in terms of their potential for changing the reimbursement rates and procedures over time, so that we're rewarding outcomes and not just volume. But some assumptions, like we can continue cutting the reimbursement rate to doctors, are pretty unrealistic. So, I think it's a combination of both.

Fairly soon we've got to have major reform of the Medicare program, and we do have in the Rivlin-Domenici report a proposal for converting Medicare to a premium support program rather than just a fee-for-service program. I think that's the right way to be thinking. It won't happen quickly. But something fairly drastic has got to be done to change the trajectory that Medicare is on.

Yes.

SPEAKER: Do you think we have a responsible government, and do you think there are incentives for either party to reach a deal in the next two years before the next election?

MS. RIVLIN: Do I think we have a responsible government? I think we have a responsible President who

will make a responsible proposal to the Congress, and I'm reasonably hopeful that something will come out of a negotiation that will start us on a track to fiscal responsibility. Part of my optimism comes from having lived through the Clinton years where we actually did it, although it was easier then. We had the wind at our back in a high-growth economy, and we didn't solve the long-run problem of the baby boom generation. We just got the closer problem solved before the long-run problem got made worse by the tax cuts and the additions to Medicare.

My other reason for optimism is actually working with these two commissions and some of the members of Congress -- and there are plenty of them -- who really understand the problem. There are some who don't. But even in the context of the commissions, a lot of education happened. The liberal denial was very clear at the beginning. The two most liberal members of the President's Commission were Jan Shakowsky from Chicago, who was Nancy Pelosi's person on the commission, and Xavier Becerra from South California, both very intelligent people. I think they started out pretty much in denial and didn't end up there. Neither of them voted for it. Jan didn't vote for it, but Jan put her own plan out, and she thought seriously about if she didn't like what these people are talking about, well, we've really got a problem and what should liberals do? And Xavier made statements that were quite supportive of the Domenici-Rivlin Plan. So, I don't want to make too much of two votes, but the intransigence is on both sides, and my hate mail comes from the liberals, and there's plenty of it: there's organizational opposition to any reductions -- no matter how far in the future -- in

Social Security benefits or Medicare, or raising the eligible ages, that is just as vociferous and angry as the conservative rhetoric.

Yes.

SPEAKER: The *New York Times* had an interactive website in the fall that basically allowed an individual to go in and solve the deficit. The biggest variable that had any impact was the wars in both Iraq and Afghanistan. Your commissions focused basically on domestic spending and entitlements, but what had the biggest impact on the budget on this *New York Times* website were the wars, so I'm curious that in your comments you haven't really alluded to our activities in the Middle East as having an impact. You mentioned the tax cuts. You mentioned entitlement spending. But what is your commission's assumption relative to these wars and anti-terrorism activities?

MS. RIVLIN: That's a short-run/long-run question. I think the reason that the wars loomed large in the *Times* exercise was that they were trying to do a fairly short-run reduction in the deficit. If you were trying to do that, then defense is a big item, and the war spending, which has gone up very rapidly in the last several years, would be a part of the equation. If you look a little longer run, which is what the commissions were focused on, the assumption is that the war spending comes down over the next couple of years. So when the proposals talk about freezing defense spending, it's not counting the war spending, which is assumed to be coming down anyway. Instead, it is freezing or cutting, depending on how drastic you want to be, the base defense budget.

The argument made by those who think that's a bad

idea is if you look at the projections, the defense budget is not part of the problem. That's also true of higher education. It's also true of anything that's in the discretionary part of the budget, because you have to make some assumption, but you usually assume that it goes up no faster than inflation or no faster than growth or whatever. It's not part of this Tsunami that is created by the entitlement programs in aging and medical care.

The defense budget, I think, has to be on the table because in this critical time, we've got to be using our resources as efficiently and sensibly as we can. There is quite a lot of waste in the defense budget, even if you accept the missions as currently defined, and we need to be thinking about whether we need to have a force as large as we have -- what are we going to use it for? Maybe we can get by with a smaller force if we're not trying to stabilize every country in the world.

That's a conversation we've got to have, but it isn't big in the numerical picture of what matters. The defense budget at the height of the Cold War was about 10 percent of our GDP. It fell to something like 3½. It's gone up now to about 4½. It's not a big part of the problem.

SPEAKER: Ever since the mid-'70s, we've had a change in the definition of higher education and the eligibility of institutions that receive federal aid. We have the not-for-profit organizations and now this large segment of for-profit institutions, which are coming under some scrutiny in terms of their practices -- the extent of their loan defaults and their recruitment efforts. It's the low-income, poor kids who are going to these

institutions in disproportionate numbers. Perhaps the Department of Education could have some different criteria for which institutions are eligible for federal largess in the form of subsidized student loans.

MS. RIVLIN: I think that's a plea for, let's get the for-profit institutions out of this equation, right? Or not?

SPEAKER: No, there are some other colleges that have terrible records, too. But I think we could have different criteria, not just based upon for-profit and nonprofit.

MS. RIVLIN: I think that's a very good education policy question, probably not much of a budget question, though it's relevant in the sense of, can we use budget stringency as a reason for doing some things that we might have done anyway to look at the effectiveness of higher education institutions, and the effectiveness of all kinds of student aid, and so forth.

I think all of these questions of whether we can use our resources better are really important, and the relevance of the budget question is, can we use the budget crisis to do things that we certainly should be doing anyway? In some ways, that's the same question for defense. That is, given that we have very serious budget problems, can we use our defense budget better? Can we use our education budget better? Can we use our health budget better? The answer to those questions is obviously "yes" in all cases. And maybe that's the bottom line message.

Yes.

SPEAKER: On the Medicare/health care front, is the end game really rationing of care in order to have a

meaningful impact on the budget?

MS. RIVLIN: Is the end game rationing care?

SPEAKER: Well, not rationing access per se, but rationing access to all procedures anytime you want. In other words, this concentration of spending in the last weeks of life. There was a lot of hyperbole around that during the health care debate, but I didn't really see anything serious come out of that.

MS. RIVLIN: We ration now. We ration by price and we ration by access. Clearly, in the long run, we can't have all the health care we want for everybody all the time. And that's already evident. I think a sensible approach to health care is to ask, how do we find ways of funding the most effective care and the most effective procedures, the things that will prolong life most, or the things that will actually cure things -- and not the things that are just palliative or life extending or actually wasteful. We can probably get rid of a lot of wasteful things before we have to go to what most people think of as rationing -- namely, saying that effective procedures can't be used for people who could benefit from them, but who by some criteria are too old or too something.

The end-of-life issue is a little complicated. It's certainly part of the picture, but it's been much exaggerated in the sense that you don't always know when you go in to the situation that it's an end-of-life situation. You only know with certainty after the fact. It's nevertheless true that a lot of spending is used in fruitless efforts to extend life a little bit, and there are certainly things we can do about that.

Yes.

SPEAKER: We've had wonderful work by you Brookings folks and a lot of other people on what a more efficient tax system would look like. I just want to ask, what's your feeling about the chances this time of getting somewhere closer to it?

MS. RIVLIN: I'm more optimistic than I've been in a long time, just because I think it's so critical. And people who weren't saying anything positive about serious tax reform are now saying it. And obviously the standard question that you get if you're somebody like me is well, wouldn't getting rid of the home mortgage deduction kill the housing market and et cetera? So, everybody defends the particular thing that is dear to their heart.

I think the only way that anything's going to happen is not by incremental change but by a serious dramatic change, and I think that might just happen. And I'm not talking 1986 tax reform, which was pretty good but it was incremental by the standards of some of the things we're talking about now. I think you really have to be willing to say, okay, let's blow it up and start over and see what you would really need to bring back a fair and efficient tax system -- and that doesn't lead you to bringing back very much. You've got to do something like an earnings credit, and you probably have to do something like a child credit, and it may be good to bring in a low-level mortgage credit -- but credit, not deduction, and not nearly as big. There wouldn't be very many of the charitable deductions.

So, if you were to start with the blank slate, it would be very different than if you start with the existing tax code. That may be too optimistic. Probably is. Some

will say it's all bunk and nothing will happen. But the consequences of nothing happening are pretty serious.

Yes.

SPEAKER: Just a quick question, a follow-up. Do you have an opinion about VAT -- value-added tax?

MS. RIVLIN: Hard to say. We put what we called a "debt-reduction sales tax" -- we didn't call it a VAT, although we expected it to be a VAT -- in the Domenici/Rivlin plan. The politics of this are really, to my mind, quite strange. Many conservatives like the idea of a national sales tax as long as you don't call it a VAT, and the only reason for not calling it a VAT is that sounds too French, too European. (Laughter) I kid you not. Serious people say this. And the liberals on the other hand say oh, we can't do that because it's regressive. Well, it's not nearly as regressive as cutting the spending programs that would have to be cut if you don't do it, but it's hard to get that across. Liberals just think that it can all be solved by raising the income tax in the top brackets and it'll all go away. So, the reality check: I'm in favor of it, but I think the politics are against it for the near term,

Yes.

SPEAKER: What are your thoughts on the timing of a debt crisis and whether it can be addressed in the next congressional session over the next two years? The issue of timing seems to be related to the assumptions that you have in both your report and in the bipartisan report about the interest expense of funding the deficit. Both assume fairly modest rates. But it's clearly a crisis by 2020 -- I believe it's a trillion dollars net new expense, and

that's at current modest interest rates, and yet that's nine years away. So, I'm wondering, when you think about the timing, what do you think is realistic to assume?

MS. RIVLIN: Oh, I think the potential for debt crisis is much sooner, and then once it starts happening the interest rates go up very fast and you've got a much worse crisis than you thought you had.

I think it's in the range of two years or three years or so, not ten years. But we've got an even closer problem here. We've got the debt ceiling question, and so the optimistic scenario I think is that we do have responsible government. You have a President and a Congress negotiating before they hit the debt ceiling -- not full-scale legislation, but a plan to get full-scale legislation with specific rules about what it will be.

Thank you very, very much, all of you.