COMMITTEE HEARING
September 28, 2006

America's Public Debt: How Do We Keep It From Rising?"

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And Former Member of Congress

Mr. Chairman, Senator Kerry and Members of the Committee. I am Charlie Stenholm, former Member of Congress from the 17^{th} District of Texas and currently a Senior Policy Affairs Affairs Advisor at Olsson, Frank and Weeda. I am also a member of the Board of Directors of the Committee for a Responsible Federal Budget and the Concord Coalition. This testimony is my own and does not represent any position or conclusion of any of these organizations.

In my twenty six years in Congress, I worked with many members on both sides of the aisle, including several members of this committee, fighting to leave a better future for our children and grandchildren. We spent many years working extremely hard and casting many tough votes to eliminate the deficit and put us in a position to begin paying down the debt. It has been extremely frustrating to see the fruits of that labor squandered by the "deficit's don't matter" mentality that took hold in recent years. I am hopeful that this hearing and similar discussions about the dangers of continued deficits and the need to take action are a sign that the tide is shifting back to the bipartisan balanced budget consensus we had in the 1990s.

I have been asked to share my thoughts about how to deal with our nation's rising pubilc debt. My testimony can be summarized in three recommendations based on West Texas Tractor Seat Common Sense:

- First, acknowledge that we face a problem. Policymakers need to take to heart the message of The Concord Coalition's Fiscal Wake Up Tour that Bob Bixby described – our nation is on a fiscally unsustainable course and difficult choices must be confronted.

- Second, stop digging the hole deeper through debt financed tax cuts or spending programs.

- Third, begin a bipartisan process in which both parties put everything on the table and honestly negotiate the tradeoffs.

From Deficits to Surpluses and Back

In the 1990s, a bipartisan consensus in Congress recognized that we could not continue to allow deficits and debt to spiral out of control. We balanced the budget, and the benefits were enormous: the longest peacetime expansion of the American economy in 50 years, four straight years of budget surpluses, record low unemployment and poverty rates, and record high homeownership. In January of 2001, the Congressional Budget Office projected a budget surplus of $5.6 trillion over ten years. We were on path to paying off the publicly held debt. There were even warnings that we were in danger of paying off debt too quickly.

Today, our nation has returned to the era of deficits as far as the eye can see. The national debt broke through the $8 trillion barrier, a number that seemed incomprehensible just a few short years ago. The national debt is on track to exceed $10 trillion in debt by 2008 or early 2009.

The recent news that the deficit for 2006 will be nearly $60 billion below the $318 billino deficit recorded last year is good news, but the fact that a deficit of $260 billion is a cause for celebration is in itself an indication of how deep of a hole we have dug for ourselves. Even more troubling is the fact that most analysts have warned that the modest decline in the defict is temporary and will be followed by deficits climbing back over $300 billion. An update on the budget outlook issued by Goldman Sachs earlier this week estimated that the 2007 deficit will be $300 billion and will continue to grow in nominal terms and as a percentage of GDP through the rest of the decade. Goldman Sachs estimates that the cumulative deficit over the next decade will total $4.4 trillion. These estimates are in line with the estimates of other indpenendent analysts. These sobering assessments should temper any celebrations about the temporary decline in the deficit this year.

As my former colleague in the House Blue Dog Coalition Jim Cooper and others have pointed out, those numbers actually understate the true size of our fiscal shortfall. The Financial Report of United States Government issued by the Treasury Department calculated that the government ran a deficit of $760 billion 2005 on a net operating basis, and that number does not even include the accrued obbligations of Social Security and Medicare. The Government Accountability Office estimated that our total fiscal exposure of the federal government are in excess of $46 trillion.

It is true that our nation has faced unexpected emergencies that have contributed to the deficit, but that should not be an excuse for fiscal irresponsibility. Many of us warned that the anticipated budget surpluses were only projections and that it was dangerous to make commitments using all of the projected surpluses without leaving any room for error. We warned that if the projections didn’t turn out exactly as hoped, we would return to deficits. We should have set aside some of the projected surplus as a cushion to prepare for unanticipated costs. And when we were faced with those unanticipated costs, we should have gone back and made changes in our budget plans.

Deficits Do Matter

Some defenders of our current economic and fiscal policies have argued that deficits don't matter. The reality is that deficits do matter, both for our economic security today as well as the future we leave for our children and grandchildren.

The United States has been able to sustain large budget deficits without an increase in domestic interest rates because the increased demand for borrowing has been offset by an increased inflow of capital from global markets. Our increased reliance on foreign capital to finance our deficits places our economic security at the mercy of global bankers and foreign governments. If foreign investors stop buying US bonds we would face higher inflation and higher interest rates, putting our economy at risk of a large scale recession.

Large deficits financed by borrowing from foreign investors are also a major factor contributing to the trade deficits which are exporting jobs overseas. We need to keep the value of the dollar high in order to attract the foreign capital we need to finance our debt. If the value of the dollar declines, US bonds will be less valuable to foreign investors. But the strong dollar we need to help Treasury finance our budget deficits hurts our businesses by making US exports more expensive.

Our current borrow and spend policies are worse than the tax and spend policies of the past, because they will leave a crushing debt tax burden for future generations who don't have any say in what we are doing and don't benefit from the tax cuts and spending programs for current generations. Our grandchildren will face ever higher tax burdens simply to cover increasing interest payments instead of addressing other needs such as keeping our military the strongest in the world, protecting our domestic security, providing health care, strengthening Social Security and Medicare, and investing in our education system.

A German philosopher named Dietrich Bonhoeffer once said that the ultimate test of a moral society is the kind of world that it leaves to its children. We cannot leave it to our grandchildren to shoulder the enormous burden of our debt. Our grandchildren do not have a vote. That is why it is so easy for us to say here today we can fight two wars, we can fund homeland security, we can fight the war on terrorism, we can rebuild the Gulf Coast and we can keep cutting taxes, because we are going to send the bill to our grandchildren.

One of my proudest moments in Congress was when the House passed the Balanced Budget Amendment to the Constitution, and one of my greatest disappointments was when the Senate fell one vote short of approving it. A Balanced Budget Constitutional Amendment and strong budget enforcement rules would protect the rights of future generations who are not represented in our political system but will bear the burden of our decisions today. If a Balanced Budget Amendment were already in the Constitution, we would not have been able to enact the budget policies advocated by the majority that have resulted in a rapid increase in our national debt.

The First Step Toward Getting Out Of The Deficit Hole: Quit Digging

My philosophy on budget issues has always begun with some simple West Texas Tractor Seat Common Sense – When you find yourself in a hole, the first rule is to quit digging. Unfortunately, the legislative agenda is filled with items that would dig the hole deeper through tax cuts and increased spending. The most notable example was the so-called trifecta bill which combined a temporary extension of business tax breaks, a permanent reduction in the estate tax and a new mandatory spending program for mine reclamation along with an increase in the minimum wage.

The Trifecta Bill is an example of the worst kind of legislative log-rolling: a debt-financed extension of politically popular tax breaks is used as the vehicle to advance a much larger tax cut which would result in a substantial reduction in long-term revenues and when the package ran into opposition a new spending program was added to the bill to gain enough support to overcome the opposition. While the individual items in the package may be worthwhile on policy grounds, the combination of cutting taxes and increasing spending in one bill without regard for how those costs would fit into the overall budget is a perfect example of how the legislative process has produced a large and growing debt.

Earlier this year Congress took a modest step toward controlling the growth of entitlement spending last year by utilizing the reconciliation process to address entitlements for the first time in eight years. Reconciliation bills making changes in entitlement programs as well as tax policy in order to reduce the deficit were a regular part of the legislative process prior to the surplus era. Unfortunately, the modest savings achieved in the spending reconciliation bill were more than wiped out by tax cuts enacted under reconciliation protections.

In recent years Congress has routinely used the special procedural protections under reconciliation to facilitate the passage of legislation that would increase the deficit. This is exactly the opposite way reconciliation was intended to be used. It was a bad precedent to set in a period of surpluses, and is even worse now that the budget is back into deficit. Reconciliation protections are intended to help Congress take actions that are responsible but politically difficult, not irresponsible but politically popular. Congress should prohibit the use of reconciliation protections for legislation that would increase the deficit and make reconciliation bills that achieve savings for deficit reduction a regular part of the annual budget process.

Dealing with our budget deficit must begin with reinstatement of budget enforcement rules to take away the shovels from Congress and the administration by restricting the ability of Congress and the President to enact legislation that would increase the deficit. The pay as you go budget enforcement rules and discretionary spending limits, which Congress and the President enacted in 1990 and extended in 1997 with bipartisan support, were an important part of getting a handle on the deficits in the early 1990s and getting the budget back into balance.

Reinstating paygo rules and discretionary spending limits would not balance the budget by themselves, but would represent an important first step in bringing discipline to the budget process by prohibiting policy changes that would further enlarge the deficit. They have been tested, and they worked. They didn't always work perfectly, but there is no question that they significantly improved the responsibility and accountability of the budget process.

The principle of paygo -- if we want to reduce our revenues or increase our spending, we need to say how we would pay for it within our budget – is something all families understand. If we want to reduce our revenues, we need to say what spending we will do without. If we want to increase spending, we need to say where we will come up with the revenues for the new spending or what other spending we will do without.

The concept of applying PAYGO rules to all legislation -- spending and revenues -- has received support from both sides of the aisle since it was originally enacted. "Two-sided" PAYGO was originally enacted in the bipartisan budget agreement of 1990 and extended in the bipartisan balanced budget agreement of 1997. Furthermore, it was included in the budget passed by the Republican Congress in 1995. Applying pay-as-you-go rules to tax cuts does not prevent Congress from passing more tax cuts. All it requires is that Congress must identify another source of revenue or spending reduction if it wants to enact or extend a tax cut.

Those who want to extend expiring tax cuts or make the tax cuts permanent should be willing to put forward the spending cuts or other offsets necessary to pay for them. Similarly, those who want to spend more in certain areas need to be willing to say where they would cut or how they would raise revenues to pay for their proposals.

I would say with all due respect to my Republican friends that if you are sincere in what say about controlling spending, you should not have a problem with reinstating pay as you go for taxes as well as spending because it would force Congress to actually cut spending to accompany tax cuts instead of just promising to cut spending in the future. The problem is that the actions of the majority in Congress haven't matched the rhetoric. Congress and the administration have cut taxes without cutting spending, and have charged the difference to our children and grandchildren by increasing the deficit.

The pay-as-you-go principle is not simply a matter of bookkeeping, but a key element of sound economic policymaking. A recent report issued by the Treasury Department providing a dynamic analysis of proposals to permanently extend the 2001 and 2003 tax cuts illustrate the importance of offsetting the revenue loss from tax cuts. Although the report cited economic models which found that certain tax cuts can result in higher savings and increasing capital stock the report noted that "when lower taxes on capital income are financed initially by issuing government debt, private investment is crowded out by an increase in government borrowing," limiting the economic benefit from the tax cuts. The report went on to say that in some instances the benefits from tax relief that increases the deficit are more than offset by the financing of government debt.

No reputable analyst believes that cutting taxes will result in higher revenues than would have occurred without the tax cut. While some tax cuts may result in economic growth that produces some revenue feedback, there is no credible analysis that claims those potential benefits would offset the revenue loss. Analyses from the Congressional Budget Office, the Joint Committee on Taxation, the Federal Reserve Board, and the President's own Council of Economic Advisors have all concluded that the tax cuts enacted over the last four years will have little or no impact on long term economic growth and cause deficits to be larger than they otherwise would have been.

Put everything on the table

A serious discussion about balancing the budget will require both parties to make sacrifices. All areas of the budget must be on the table and the burden of deficit reduction should be distributed fairly across the budget. I have always said that those of us in agriculture are willing to accept our fair share of reductions if all other areas of the budget are asked to sacrifice as well, but we aren't willing to shoulder an undue burden of cuts so that other areas of the budget can avoid budget discipline. I believe that this view is shared by advocates of other areas of the budget as well.

The Promise to Our Children and Grandchildren being circulated by For Our Grandchildren, a bipartisan Social Security education organization which has retianed me as a spokesman, embodies this approach. The promise asks candidates to seek an honest, bipartisan debate about Social Security and find responsible solutions to meet these challenges that the system will face in the years ahead. It doesn't commit candidates to any specific policy proposals. Rather, it calls on policymakers to put all options on the table to develop a solution which honestly addresses the pressure that the unfunded obligations that the current system will place on taxpayers and other budgetary priorities in a way that is fair to all generations, protects current retirees and strengthens the safety net for the most vulnerable. If all candidates from both parties conduct themselves in this spirit in the debate over Social Security and our other fiscal challenges it will be much easier to reach bipartisan agreement on responsible solutions.

The renewed public focus on the need to address the long-term problems facing entitlement programs has been encouraging. However, rhetoric about the need to make tough choices with regard to entitlement programs is undercut when it is not matched by a willingness to make similarly tough choices on the revenue side of the ledger. It is fiscally irresponsible and politically unrealistic to call for reforms of entitlement programs in the name of fiscal discipline while simultaneously advocating tax cuts that will make the short term deficit and long term fiscal imbalance worse. It is neither fiscally responsible nor politically viable to make cutbacks in some areas of the budget in the name of deficit reduction while exempting other areas of the budget from budget discipline. That is particularly true when deficit reduction efforts focus on the most vulnerable in society, while benefits for those in a better position to accept sacrifices are left untouched. It will take everyone pulling to get the wagon out of the ditch; we won't be able to get it out if some people are riding.

One specific proposal that would provide a substantial source of savings in a way that spreads the burden of deficit reduction broadly is utilizing a more accurate measure for indexing government programs as well as tax brackets and other provisions in the tax code. There is broad agreement among economists that the Consumer Price Index currently used for indexation of government programs overstates inflation.   The Bureau of Labor Statistics has begun to publish a new "Chained Consumer Price Index" to provide a more accurate measure of inflation. Using the Chained CPI for indexation of government programs represents sound policy that reflects years of work by economists and other technical experts. Just as importantly, this proposal would achieve substantial budgetary savings – approximately $50 billion over the next five years -- in a way which would spread the burden of deficit reduction fairly across the entire span of government.

Increasing the Debt Limit

This Committee has been called on to raise the debt limit four times in the last five years to finance our deficit problem, and probably will need to be asked to do so again next year. While raising the debt limit is something that Congress must do, increasing the debt limit should be accompanied by a full and open debate about the fiscal policies that have made the increase necessary and a discussion about what should be done to stem the tide of red ink. In addition, I believe that any long-term increase in the debt limit should be accompanied by a plan to restore fiscal discipline. I would propose that when Treasury indicates that it is nearing the debt limit Congress approve a short term increase in the debt limit to avert the imminent crisis and provide for a longer increase in the debt limit contingent upon Congress taking action to reinstate paygo rules and other budget enforcement mechanisms.

Addressing Long-Term Fiscal Problems

Although our near term budget deficits are cause for concern in their own right, what makes them particularly worrisome is the looming financial pressures we will face when the baby boom generation begins to retire in 2008. We need to bring more attention to the long-term liabilities facing our nation as part of the budget process.

I had hoped that last year would be the year that Congress and the President would take action to address the financial challenges facing Social Security, but neither party seemed interested in a serious discussion about the tough choices that will be necessary. These challenges will continue to get worse and become harder to address the longer we wait.

According to projections by the Government Accountability Office (GAO), the combination of allowing the growth of entitlement programs to continue unchecked and making tax cuts permanent while keeping discretionary spending constant as a percentage of GDP will result in a deficit of 10 percent of GDP by 2024.   By 2030, the costs of Social Security, Medicare, Medicaid and interest on the debt would consume nearly 22 percent of GDP and the debt to GDP ratio would be 150%.

While the higher revenues from allowing the tax cuts to expire would fall far short of closing this long-term fiscal imbalance, it makes no sense to make the gap worse by locking in permanently lower revenues *before* restraining the growth of entitlement spending. Unless Congress enacts major reforms slowing the growth of entitlement spending, revenues will need to increase well above current levels to meet these obligations and keep up with the growth in spending associated with the baby boomers' retirement and health care costs. Congress should defer action on any tax cuts or entitlement spending increases with long term costs – including extension of the tax cuts which expire in 2010 or expansion of Medicare prescription drug benefit -- until Congress has addressed the existing long-term fiscal challenges.

There is no magic bullet that will solve our long term fiscal challenges by itself. While stronger economic growth will help meet the burden of an aging population, higher economic growth alone will not be enough. GAO has estimated that we would need double-digit real economic growth for many decades to grow our way out of the fiscal problems. Slowing the rapid growth of health care spending will need to be part of the solution, but a substantial gap would remain even if we were somehow able to eliminate all excess health care cost growth. Propososals that have been put forward to raise revenues to finance the growing costs of entitlement programs should be considered, but it is unrealistic to expect that it is politically feasible or economically desirable to raise taxes enough to close the gap. Although I personally believe that individual accounts can be an important component of a comprehensive reform plan by providing a higher returns on worker contributions and a more reliable method of pre-funding benefit promises than government trust funds, they do not provide a painless solution to the financial challenges facing Social Security as some have claimed.

A serious solution to our long term fiscal challenges will likely require some combination of stronger economic growth, restraining the growth of health care costs, scaling back benefit promises of entitlement programs, increasing the eligibility age for Social Security and Medicare, increasing revenues, and other tough choices. There is plenty of room for debate over the exact mix of options that should be included in a plan, but policymakers need to begin by acknowledging that the solution will require tough choices and difficult tradeoffs.

Fiscal Commission

The experience of last year in which neither party in Congress was willing to take action on the financial challenges facing Social Security convinced me that we need to establish a bipartisan commission to objectively review the fiscal challenges facing our nation and make recommendations to Congress and the President about how to put the nation back on a fiscally sustaiable course.

Senator George Voinovich and Congressman Frank Wolf have introduced legislation, the Securing America's Future Economy (SAFE) Act which would establish such a commission. The commission would solicit input from the public and develop proposals to address four key concerns:

1) The unsustainable gap between projected spending and revenue,
2) The need to increase national savings,
3) The implications of foreign ownership of U.S. government debt, and
4) The lack of emphasis on long-term planning in the budget process.

Congress and the president would be required to act on the proposal developed by the Commission under a fast track procedure.

Senator Chuck Hagel, a Republican from Nebraska and Congressman John Tanner have introduced similar legislation establishing a commission to address the challenges facing entitlement programs, which are the primary source of our long-term fiscal challenges. The Stop Over Spending Act introduced by Senate Budget Committee Chairman Judd Gregg included a similar entitlement reform commission based on a proposal put forward by Senators Pete Domenici and Diane Feinstein.

As a former Member of Congress, I would like to believe that Congress could address these issues without the need for a commission. Unfortunately, the experience of recent years suggests that is extremely unlikely under the current political environment. Neither party wants to be the first to step out with tough choices out of fear that they will be attacked politically. Neither side is willing suggest that they are open to compromises out of fear that the other side won't reciprocate

A commission could help advance the debate, break the political stalemate and give all parties -- Republicans and Democrats in Congress, the current administration or whoever is elected President in 2008 -- the cover to to tackle the tough choices that they know needs to be made. Right now the perception is that a commission would give political cover to the current administration and leadership in Congress, but after the next election my fellow Democrats may have a greater obligation to say how they would address these issues and could use the political cover a commission would provide.

Earlier this year, the Concord Coalition sponsored a forum about the possibility of a commission to address long term fiscal issues. There were a few elements that everyone agreed were necessary for a commission to suceed:

1) The Commission must be truly bipartisan and represent a broad range of views

2) The Commission must be given a broad mandate to examine all aspects of fiscal policy, including entitlements and tax policy

3) The Commission should educate the public about the long-term fiscal challenges and engage the public in discussion potential solutions.

4) All policy options must be on the table. There should be no preconditions about what policy options can consider.

5) The commission proposal should be given an up-or-down vote in Congress with an opportunity for alternatives and amendments that would not reduce the total savings.

It is critical that members of the Commission not be asked to pass a litmus test about what options they would or would not support in a final solution. Everyone must resist the temptation to immediately shoot down ideas they don't like. Let an idea fly in the public debate long enough to consider its merits.

I agree with former Treasury Secretary Rubin that the commission should be allowed to examine rolling back tax cuts and other options to increase revenues. Increasing taxes to meet the growing costs of meeting our obligations to Social Security, Medicare and Medicaid as the baby boom generations retires is a legitimate option that the commission should be allowed to consider. Likewise, keeping taxes at current levels will require substantial changes to scale back the costs of these entitlement programs. In all likelihood the solution will require a combination of changes to restain spending and increases in revenues. The Commission should be allowed to consider and discuss the full range of options and debate the tradeoffs.

There is justifiably cynicism in Washington about proposals to establish a commission to study an issue. There are bookshelves filled with dust-covered reports from commissions that went nowhwere. A commission isn't a silver bullet that will solve our problems. It will still take action by Members of Congress and the administration to make the tough choices. But a commission that reflects the principles I have outlined could provide the leadership necessary to get the process started in a constructive fashion, especially if the President follows through on his pledge to address the issue in a bipartisan manner and continues to make addressing the long-term challenges facing entitlement programs a priority.

Conclusion

Reaching consensus on a balanced package that will prevent the publicly held debt from growing to unsustainable levels will require all of us to accept sacrifices. As long as everyone advocates balancing the budget by cutting someone else's priorities, talk about deficit reduction will remain just that. As a farmer, I choose to be an optimist and believe that all sides will be willing to put aside their individual political interests to find a solution that is in the best interests of our nation and our children's future.