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Addressing Long-Term Deficits: When and How? - Opening Remarks

First of all, I'd like to thank you John Podesta and CAP for putting this conference on. I think it's quite impressive that you've taken the initiative to do this. It's a pleasure for me to be me amidst such a distinguished group. The question is when and how? I think everyone agrees with Paul Krugman that this is not the time, today, to actually implement deficit reduction and Bob just discussed that too. Economic conditions are too weak and the impact of economic reduction cannot be absorbed today.

So the question is, if not today, when? That gets into the question whether to choose to address this deficit outlook on our own terms or do we address it on other terms. I don't precisely know of course but I tend towards the second scenario. Why? Because the fiscal outlook is simply so dire, that it is likely to transcend the capacity of our political system, to address it proactively. Let's remember, and I'm using the forecast here in the Gale paper, the 10 year path involves an annual deficit of a trillion. At the end of that period, they would equal 6.5 percent of GDP and be rising. I know that's higher than the numbers that Paul used, and we can debate those but these are reasonable forecasts. By the way, that's after economic recovery has fully occurred. And the national debt at the end of that period will reach 80 percent-85 percent of GDP. That's a figure we haven't seen since the late 1940s.

But I think the larger point is that for a nation whose national savings is essentially zero, nearly all whose increased borrowing in recent years has been furnished by foreigners, more than half of whose debt today is owned by non-citizens, and where the ratio of combined Medicare and Medicaid spending to GDP is projected to triple beyond the 10 year window. This is a truly dire outlook. It's not just a bad deficit path; it's really dire. And it's so dire of course that it won't actually occur. This isn't going to materialize. Why? Because the financial system won't accept it. And listening to Charlie Cook and others who are a lot smarter than I am about that, it doesn't look like the political system will accept it either.

Let me expand for a minute on the financial system point. We've of course seen repeated global financial crises in recent years, especially the so-called Great Panic of 2008. There's also, let's not forget, the Asian financial crisis, the Mexican default, the Russian default, and it wasn't so many years ago that the IMF was an emergency lender to Britain. Now every one of those crises had one element in common—excess leverage, too much debt. So in my view, it's virtually certain, that the rest of the world will not indefinitely lend whatever colossal amounts we need at current interest rates and exchange rates. They simply won't take the risk of that amount of excess dollar asset concentration. And that point is reinforced by the story which Bob Greenstein told of 1979. I too served in the Carter Administration, and it's really a very instructive story. Global markets lost confidence in the Carter economic policies, and finally when President Carter submitted his early 1980 budget, as Bob told the story, markets revolted. The dollar essentially crashed and an emergency international intervention was organized

to stabilize it and that involved some very punitive actions, like for example, tightening monetary policy and raising interest rates, on the part of the Fed here, and also as Bob described, drastically tightening our then paltry budget. President Carter retracted his budget, and a week later—not a month later or a year later—a week later, submitted his budget halving his proposed deficit. Now finally on timing, these things are impossible to know because they involve so much psychology. But it's my judgment, a little different from Bob Reischauer, is that we will not get through this first Obama term without actually implementing, rather than committing to later implement, at least the beginnings of long-term deficit reduction.

Then the question is how? That gets it seems to me to the size of the fiscal gap and this question of whether we do voluntarily or we do it involuntarily. And that fiscal gap of course is simply the amount of immediate annual deficit reduction which would be necessary to stabilize the relationship of the national debt-to-GDP. Chairman Bernanke has been in effect urging that we stabilize at the current level which is about 55 percent, highest since 1954 by the way, as the WWII debt was winding down. That would require up to 1.42 trillion of immediate annual deficit reduction. So if you say to yourself, we ultimately stabilize between the current level and the 80 and 85 percent level that would play out under the 10 year forecast that we have, we won't be allowed to get that far, we're talking about something like 500-700 billion of annual deficit reduction, meaning obviously a combination of spending cuts and revenue increases to that effect, 500-700 billion. Realistically, most of that will have to come from new revenue. It can't all come from new revenue, but most of it has to come from new revenue. Choose a number, 400 billion, and that is just a number that I've chosen for illustration. Now that likely requires as Bob Reischauer just said, a new source revenue, and I agree with him, that a national valued added tax would be a good possibility.

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