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War and famine. Peace and milk. – *Somali proverb*

A Strategic Policy: Investment, Social Security, and Economic Recovery Symposium

Despite the claims of crisis, the latest Trustees' report shows quite the opposite. It reveals that in 2009, Social Security ran a surplus of $122 billion and had accumulated a reserve of $2.54 trillion which will grow to $4.2 trillion by the end of 2024.

See page 10

TABLE OF CONTENTS

Opening Remarks

James K. Galbraith

Good morning, and welcome. I'm James Galbraith, Chair of the Board of Economists for Peace and Security. I would like to welcome you to this EPS Bernard Schwartz Symposium, "A Strategic Policy: Investment, Social Security, and Economic Recovery." I wish to thank our partners at the New America Foundation, who help very much with the logistical underpinnings and publicity for this symposium, and the Ronald Reagan Building and International Trade Center for making this marvelous facility available to us. Of course I would also like to thank Bernard Schwartz for his strong support (over several years now) of our efforts in framing economic policy questions at these symposia.

As we begin this morning, I'm tempted to say that a specter is haunting Washington, the specter of the Bowles-Simpson Deficit Reduction Commission – meeting behind closed doors, and occasionally dropping hints of the debate to come after the midterm elections. It is the specter of a wave of demands for cuts in Social Security and Medicare as a kind of sacrifice on the altar of fiscal responsibility. In other words, such are the problems of the federal fisc, of the public budget deficit and the national debt, that an argument is gathering force to the effect that we must act now to make severe cuts in what remains of the American social safety net. No one uses the word "privatization" anymore, but behind this campaign there are in fact the same forces that were calling for the privatization of these programs just a few years ago. Today, the program is buttressed by dire warnings of a fiscal doomsday. These are anchored in the projections of an extremely reputable authority – the Congressional Budget Office, a nonpartisan and highly respected institution.

The question facing us this morning is whether this agenda really meets the economic crisis that still faces the United States and the American people, and whether it serves the larger public purpose. If not, and I believe it most emphatically does not, then what should be our priorities in setting a new direction for economic policy in the United States in the years ahead?

A strategic direction – as we emphasize in the title of this symposium – can help set a path for the redevelopment of our autonomy, for the resumption of economic growth, and above all for the creation of jobs and tackling our vast and unsolved problem of unemployment. With that in mind, we've organized three panels this morning, around three separate aspects of this issue.

The first is to examine what is the actual state of our economy. What is the outlook? What are the true problems, and how these may be distinguished from issues which are more or less contrived in the service of an ulterior agency?

The second panel will ask, what is the true record of Social Security and Medicare? What is their actual function in our economy? Can they be sustained? Should they be sustained as they are, or even expanded in order to serve the purposes of stabilization, and to serve a role in a successful economic strategy going forward?

The third panel will look at how these issues fit into a larger picture of the need for an economic strategy that fosters economic and national security in the broadest sense of the term. In other words, what are the true priorities that we should pursue in the future?

Session One Summary: The Economy and the Budget

Chaired by Richard Kaufman

Session One panel, left to right: Heather Boushey, Michael Intriligator, Thomas Palley, Richard Kaufman

Richard Kaufman

I want to say a few words amplifying the opening remarks that James Galbraith just gave us as they relate to the deficit. The topic of this panel, "The Economy and the Budget," leads inevitably to thoughts of deficit spending. But how and when do deficits matter? Do they matter in different ways at different times in the economic cycle? Are present trends leading towards crippling deficits? How can deficits be usefully employed now and over the long term to reduce unemployment and achieve sustained economic growth?

These are some of the questions that might be addressed in discussion about economic policy. What passes for debate and discussion today is far from reasoned. Conservatives have demonized deficits as a product of reckless spending, as a plot to destroy America as we know it. Liberals and progressives suspect, with good reason, that the deficit hysteria is being used to support a not-so-secret agenda to prepare the ground for frontal assault against Social Security and Medicare.

Thomas Palley

The one thing I always like to do when I give a talk is to make sure that I deliver my main message, and so here you have it: "Fiscal austerity is a trap." It is a trap that risks sabotaging growth, that risks producing self-fulfilling budget difficulties.

The US economy is struggling to escape the deepest recession since the Great Depression of the 1930s. Many in Washington and in the policy establishment are arguing that government is the problem, and that we need fiscal austerity.

Our challenge is two-fold: we need to discredit the fiscal austerity agenda, and we need to create support for a new economic agenda that includes public investment. Instead of Larry Summers' "timely, targeted, and temporary" stimulus, we need "substantial, smart, and sustained."

The problem is that we have been stuck since the late 1970s in the "neoliberal two-step." Step one is to adopt neoliberal economic policy and create a problem. Step two is to claim that more neoliberal policy is needed to solve the problem. It really is that simple.

That is exactly what's going on with the budget deficit debate in this talk about taxes: irresponsible tax policy creates huge budget deficits, and then we need more irresponsible tax policy to get out of it.

The same holds for regulation, labor market policy, trade policy, and Federal Reserve policy. We have to discredit neoliberal policy because these problems cannot be fixed until we restore a pro-people, shared-prosperity policy. But that's really very tough because a lot of Democrats, the media, the voters, and almost the entire economics profession believe in neoliberal economics in one form or another. I'm going to argue now for three reasons why we need sustained deficit-financed fiscal policy.

Reason number one: we still need stimulus to jumpstart the recovery. There is a shortfall of private sector demand, and in that situation, the government should step in and plug the shortfall to prevent a deeper recession. In 1937 the Roosevelt administration succumbed to political pressure for deficit reduction, and there was a second dip or second recession in the midst of the Great Depression.

Reason number two: to facilitate private sector deleveraging. The role of government in this type of economic situation is to run deficits, to take the private sector's excess savings, then rebuild the private sector's balance sheets by supplying bonds and spending those savings.

Reason number three: to spur economic growth. Deficit-financed public investment can play a very important role in a new growth model. We know that public investment has a high rate of return, and after 30 years of low public investment, we have the need and the opportunity. The fiscal austerity agenda risks creating a vicious circle that lowers growth and tightens the fiscal noose.

This is a critical message we need to get across to people. Fiscal stimulus has already created jobs, and helped reduce the scale of job loss. The budget deficit now is also helping us through the deleveraging cycle.

If we don't abandon neoliberal policy, which includes the terrible neoliberal fiscal policies of the last 25 years, the economy will underperform. Eventually, we will be stuck in a true fiscal crisis. Let's begin by getting fiscal policy right.

The Economy and the Budget

Heather Boushey

There is clearly an output gap in the US economy. As a labor economist, what I most focus on, each and every day, is the massive number of unemployed and the need to get those people back to work, to fill in that output gap.

The question is, how can we fill it? How can we get back to full employment when people are concerned about deficits, where the mantra is now about tax cuts?

Back into 2008, when we elected President Obama, unemployment was already starting to rise. Output was falling. During the transition, before he took office, Christina Romer ran three simulations on what was needed to get the economy back on track: one, a recovery package about $600 billion; one for about 800 billion; and one for 1.2 trillion. Based on her analysis, and her understanding of the Great Depression, she came to the conclusion that the $1.2 trillion package was needed to fill in a two trillion dollar output gap.

As we now know, that proposal really never made it to the President's ear. Even though we knew about this output gap and could see the labor market falling off a cliff, we weren't we talking about it. Why?

First, Congress: the sticker shock of 1.2 trillion would just make everybody fall flat on their backs, and there was no way that that was going to go through Congress. That's probably a fair assessment. Second, the slow pace of government bureaucracy. How fast can government pick up and throw that much money out into the economy in a way that's smart and targeted at growth? The third issue, of course, that Dr. Summers brought up is that there would now be deficits that would impact the bond market. Of course, we haven't seen them in the negative way we might have thought.

Here I come to the notion of clear, comprehensible, and credible. This is the moment where I often think of people like my mom, who's a good person, typically votes Democratic, not an economist, doesn't get it. You can't explain to her why we can have deficits from now until as far as the eye can see, without making something bad happen to the economy. You can't connect to people with that message.

I think we actually lost this debate a decade or more ago when the national conversation was what to do with the Clinton era surplus. The answer was to give it to rich people because they create the jobs. We gave massive tax cuts to the richest people in this country, and that led to the lowest investment growth in the post-World War II period, and the lowest growth in employment in any economic recovery. The rich people didn't invest, because basically the money was given to people like Paris Hilton; it wasn't targeted and didn't create jobs. The American public doesn't understand that disconnect.

Now we're having a debate about tax cuts for the wealthy. I would like to encourage us today to think about how we're going to communicate with people like my mom, who just can't wrap their heads around the fact that we need these deficits. For ten, twenty, thirty years, they have been told that what gets our economy going is rich people investing.

Back in the Great Depression, when we passed all these great things that we're always pointing back to – the Social Security Act, the Fair Labor Standards Act – the debate was different. They raised the minimum wage because people understood that workers bought stuff. That link isn't there for most people these days. That is the challenge we face: to reshape the conversation so that people understand that if we don't spend, people can't buy.

Michael Intriligator

The National Bureau of Economic Research (NBER) has been tasked by the US Federal Government with the responsibility of dating the beginning and end of recessions. They've been doing that for many years, and have a very distinguished group of people. Recently, they dated the end of the Great Recession as June 2009. This was a huge mistake, and it gave all the wrong signals to politicians and to

Continued on page 4

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Contact us:
EPS at the Levy Institute
Box 5000
Annandale-on-Hudson, NY
12504
USA

Tel: +1 845.758.0917
Fax: +1 845.758.1149
Email: info@epsusa.org

Contact the editor:
catcohen@epsusa.org

Session One: The Economy and the Budget (continued)

policy makers, etc. I don't think that date is correct. I find it doubtful, given the continuing high unemployment, foreclosures, loss of savings and equity, difficulty in getting credit (particularly for small business), and bankruptcies of individuals, corporations and smaller banks.

It will take years before the current crisis will end. The normal recovery forces that we've seen in previous recessions won't work. Virtually every state is in deep financial difficulties. Banks are not lending, particularly to small business. When I talk to small business owners, they say they have all kinds of plans: to hire people, put up new buildings or whatever, but they can't get the loans. There's no credit available for them. There's no international locomotive of growth. In previous recessions we believed that if we were in trouble, some other countries (the EU, China or Vietnam) would bail us out. But that locomotive doesn't exist anymore.

I predict that the GDP of $14.26 trillion we realized in 2008 will not be achieved again on an inflation-adjusted basis until 2013. I also think that unemployment will not fall back to a level of 6.25% until 2016. So, we have another three to six years to go before this recession ends.

How do we navigate out of the current crisis? I see a false choice between economic stimulation and greater regulation. It's not one or the other; we need both. We require greater transparency and limits on leverage for banks. And, if we're going to have more stimulus funding, there should be some specific requirements on people who get the money, that they use it for some valuable things rather than bonuses and trips.

We made the mistake of working from a top-down idea, bailing out these huge financial institutions and corporations. We should move to a bottom-up approach instead, including measures such as family housing vouchers, guaranteed mortgage assistance, support for small and medium-sized businesses, extending unemployment, health insurance, student loans, and aid to states and localities.

The federal government is actually required by the Employment Act of 1946 to promote full employment. There are several ways to achieve this. We need a government guarantee for a portion of the commercial investment bank loans, as in Small Business Administration guarantees. If banks don't provide credit, then we should use close supervision by the Fed with restructuring, receivership or even nationalization, as a last resort. Then, if businesses don't provide jobs, the government should act as the employer of last resort, like under FDR.

The various Depression era programs such as the Works Progress Administration and the Stability and Conversation Corps built many of our roads, post offices, public buildings, and national parks that we still benefit from today. We should resume some of those programs for both employment and infrastructure investment.

UPCOMING EVENTS

February 25 — 27, 2011. The Eastern Economic Association's 37th Annual Conference will be held at The Sheraton New York Hotel and Towers, New York City. See http://www.ramapo.edu/eea/2011/.

April 26 — 29, 2011. 9th Biennial Pacific Rim Conference will be held in Brisbane, Australia, hosted by Queensland University of Technology's School of Economics and Finance. Program highlights include keynote addresses by Edward J. Kane, Boston College, and WEAI President Paul A. David, Stanford University. Information is available at http://www.weainternational.org/.

June 16 — 17, 2011. Fifteenth Annual Conference on Economics and Security will be held in Bristol, UK, hosted by Economists for Peace and Security (UK), the University of the West of England, and Bristol University. If you would like to present a paper, please send a title and an abstract of less than 300 words as soon as possible. Both should be sent before April 1, 2011 to John2.Dunne@uwe.ac.uk. For more information, visit http://carecon.org.uk/Conferences/Conf2011.

June 27 — 29, 2011. 11th Annual Jan Tinbergen Peace Science Conference will be held at University of Amsterdam, The Netherlands. Go to http://www.europeanpeacescientists.org/jtinbergen.html for more information.

June 29 — July 3, 2011. 86th Annual Conference of The Western Economics Association International will be held in San Diego, California. Visit http://www.weainternational.org/ for further details.

Keynote Address

Barbara Kennelly

James Galbraith
I'm very happy to introduce our first keynote speaker. We're privileged to have, as a speaker, one of the country's great authorities on the Social Security system. Congresswoman Barbara Kennelly served 23 years in electoral office and 17 years in the United States House of Representatives. She was the first woman to serve as Chief Majority Whip, and only the third in history to serve on the Ways and Means Committee, which speaks well of her, and not so well of the Ways and Means Committee. During the 105th Congress, she was the ranking member of the Subcommittee on Social Security. After serving in the Congress, she was counselor to the Commissioner of the Social Security Administration, that Commissioner being my dear friend and former LBJ School colleague Ken Apfel. She has since become the President and Chief Executive Officer of an extremely important enterprise, the National Committee to Preserve Social Security and Medicare. Having said that, I just welcome you, Congresswoman Kennelly. Many thanks for being here.

Barbara Kennelly
Thank you very much. I never consider myself an expert or an authority on Social Security. Having been in elective office for 23 years, I know a little about a lot of things, but I am not an expert at Social Security. I do, however, have a number of experts on Social Security and Medicare in my office.

Today, I would like to talk about these important programs, not merely as budget issues, but put faces behind the numbers. The National Committee Members are these faces. The National Committee to Preserve Social Security and Medicare has three million members and supporters. These people come from all walks of life, of all political persuasions, but what they have in common is their absolute passion to protect Social Security and Medicare.

This summer in August, we celebrated the seventy-fifth anniversary of Social Security. It gave us a very wonderful opportunity to reflect on the importance of this program. I will recall to you Franklin Delano Roosevelt's words when he signed the Social Security Act: "We can never insure 100% of the population against the accidents and vicissitudes of life. But we have tried to frame a law that will give some measure of protection to the average citizen and to his family against the loss of his or her family, against the loss of a job, or against a poverty-ridden old age."

> **Social Security is the only program with an automatic cost of living increase. It keeps up with inflation. It's especially critical to the oldest of the old, mostly women who didn't have a lot of resources.**

This was a bedrock promise that President Roosevelt made. The whole idea was after a lifetime of work, Americans would protect seniors in their retirement. Social Security was never meant to be a welfare program – certainly not – nor a charity. It's an earned benefit, built on twin goals of equity and adequacy. We pay in during our working years; I'm sure all of us here pay in, as I do. We get return when we retire. I am so always amazed that people don't know how really not-exactly-generous are Social Security benefits. The average benefit of Social Security is $14,000. For women, it's just a little below $12,000. That's really not much to live on, but it does let seniors have a life of dignity and independence.

Social Security really has been our nation's jewel. It's been a very important and popular program, until very recently, with almost everybody. It lifts half of individuals who are retired out of poverty. Family benefit is a family benefit, not just a retirement benefit, regardless of whether the breadwinner has retired, died or is disabled. One out of three beneficiaries – and we don't often talk about this – are not seniors; they're either disabled or they have left their families and the Social Security is needed. Social Security is the only program with an automatic cost of living increase. It keeps up with inflation. It's especially critical to the oldest of the old, mostly women who didn't have a lot of resources. By the time they get older, they've run out of those resources. Social Security is incredibly important to them. The 85 and older group, who really need Social Security, is the fastest-growing demographic in our population.

Some of you probably – knowing this audience, certainly – paid attention to the Census Bureau poverty data that came out last week. Poverty increased for children. But we also saw that the only group to experience a decline in poverty was seniors. One of the reasons is that in 2009, we had an exceptionally high cost of living adjustment; 5.8% was the COLA. That was the result of the spike in oil prices, when the formula was figured as a benefit. The other reason, the big stimulus bill that we had, included a $250 check to seniors. This shows how close seniors are to poverty, in that these two changes could ensure that they didn't descend into poverty. Unless the Congress acts, we're not going to have a COLA this year or next year. I don't think we're going to see a 5.8% spike as we did two years ago.

I can't discuss Social Security without discussing Medicare. For many seniors, Medicare is their single out-of-pocket expenditure. Part B premiums are deducted from Social Security from the check, and many seniors kind of think of these programs together. Medicare provides healthcare to a population shunned by the insurance companies. I represented Hartford, Connecticut, the former insurance capitol of the world, for 17 years. I understand insurance. The insurance industry had

Continued on page 6

Kennelly Keynote Address (continued)

absolutely no interest in covering seniors because they have too many claims. Insurance companies have to be responsible for profits and to their shareholders. Medicare provides health insurance to a population that was shunned and now it covers these benefits. Today's Medicare is affordable insurance to elderly with disabilities.

Having said that and having said how important Medicare is, we have to remember that Medicare uses the same doctors, the same hospitals, the same MRI machines as our whole healthcare system. A senior now spends an average of 40% of Social Security benefit on out-of-pocket expenses. We need to contain costs across the board, and not just look at Medicare for cuts. That's why my organization supported the Healthcare Reform Bill. I have never seen legislation that had so much information, much of it directed to seniors. That was because seniors care so much about Medicare, and also because seniors vote in midterm elections. Of course, much of what was going on in the healthcare reform had political implications. Seniors were bombarded with distortions, half-truths, some outright lies. I don't care how many times you read the Healthcare Reform legislation, you cannot find death panels; they were never there. When seniors are polled, they still believe there are death panels, and this is very harmful to the program.

The National Committee, my organization, spent millions helping members to understand the truth, and we have no political agenda. Our membership is split one third Republican, one third Democrat, and one third unaffiliated. But we know that the status quo was not an option for Medicare. You just can't cut Medicare without the rest of healthcare being addressed. If we do, providers will withdraw from the program, and as a result, seniors will have a very difficult time finding a doctor. The Affordable Care Act was a unique opportunity to strengthen Medicare while slowing the cost of healthcare. It protects access for seniors while keeping Medicare affordable. It's not a perfect bill; most of them aren't. But it's a beginning on Medicare reform and healthcare reform.


Keynote speaker Barbara Kennelly

Those who oppose the whole idea of healthcare reform were talking repeal before the ink was dry on the President's signature. No matter what happens in the fall's election, we're not going to have repeal. The President would not sign any veto of Social Security, but there are lots of ways to undermine this program. Chipping away at the less popular provisions has already begun. Small business can't stand the reporting regulations. They're absolutely hated by small businesses. But if the legislature hadn't enacted them, $13 billion would be lost to preventive healthcare. Individual mandates aren't popular either; in fact, they're hated by many people. But without them, the economics of the whole healthcare bill wouldn't work.

We have to pledge to keep some of these popular positions. I say pledge, as I think many of you saw last week that the Republicans have a new pledge. It includes little pieces of repeal of Medicare. It prohibits insurance company rescissions and pre-existing condition denials. Very popular, but if you attack them singly, there's a chance they could pass. We also have to worry about starving the program of resources. Health reform, if you read the bill, is an unbelievable amount of regulation. Congress could refuse to appropriate the money for the regulation, and that could stop healthcare in its tracks. Many provisions don't take effect till 2014; that's plenty of time to organize repeal activities. Those of us who believe that a country as advanced as the United States of America should have a robust social insurance program will have to fight to keep these programs.

On the twenty-fifth anniversary of Social Security, Frances Perkins, the hero, Labor Secretary of Social Security said, "One thing I know. Social Security is so firmly embedded in the American psychology today that no politician, no political movement, no political group could possibly destroy that act and still maintain our democratic system. It is safe. It is safe forever, and for the everlasting benefit of the American people." Well, that may no longer be true. Forces are at work, using legitimate fear about deficits as their weapon, to undermine the Social Security program. There are those in very important positions who claim we can no longer afford Social Security. I'm appalled as anybody that we have a deficit of $1.5 trillion. I can remember when $200 billion was considered a real problem. The Social Security system has been running surpluses that mask the real amount of the deficits, as we well know. What we also have to know is that Social Security has not added one thin dime to the deficits. Americans have always contributed to the program and expected to have Social Security when they retire. It is a very safe retirement instrument. The treasury bonds are backed by the full faith and credit of the United States of America.

The problem is – the enemies of Social Security won't say it, but – they don't want to honor these bonds. Fiscal hawks' drumbeat is that we can't afford it. Policymakers may be listening. Why? The President appointed a fiscal committee that has been moving very rapidly. Do we know what the fiscal committee has been suggesting? Not much, because they have their public meetings by law, but the subcommittee meetings are held with no publicity whatsoever. We don't know what these secret deliberations are going to do to our program.

We have to plan by what they're going to do. We have public statements by people like Mr. Bernanke and others who say everything should be on the table, but the only things that we see on the table are cuts in benefits. The Fiscal Commission won't meet again until after the election. In fact I get a kick out of it - the date for the next meeting, I think, is

Kennelly Keynote Address

November 3; Election Day is November 2. Usually people are pretty tired after the election. I don't know exactly how many people are going to attend this meeting, but the Commission has a strong group of people who really don't believe in Social Security. They've made it very clear that they just don't want to raise revenues. If you don't raise revenues, you've got to cut benefits. A woman of great renown on the committee, Alice Rivlin, has always been for capping entitlements. She is trying to talk the Commission into that.

Raising the retirement age is right there out front. "Let's raise the retirement age to 70." The reason for that is that the average life expectancy has increased. Well, sometimes averages can be shaded one way or the other. The average life expectancy has increased for those that are healthy and wealthy, like people who are members of the Commission. Most people would love to keep their jobs, but can't. Their health isn't there, or the job isn't there. To increase the age to 70 without thinking about retraining, or about changes in the pension law, or that we are in a recession (and we don't know how long that is going to last), is very imprudent. Another thing on collecting benefits: some people have to retire early, either because they don't have a job or their health isn't good. Taking benefits at the early retirement age of 62, the benefit is cut by 20% originally. Raising the age to 67 cuts the benefit by 30%. If we raise the age to 70, benefit could be cut by almost 40%. That becomes a poverty wage.

We also hear a lot about changing the way we index the formula of benefits. It's a complicated idea that sounds progressive, but over time it breaks the important link between contribution and benefits that Social Security has had for 75 years. It could leave everybody once again with a poverty level benefit. I really am not one who would unconditionally oppose any reductions. I wouldn't just say, "Don't touch it; touch everything else, but don't touch Social Security." What I want to ask the Commission, when they're only talking about Social Security, is "Why don't we hear about anything else?" Until we are informed about other things, we can't have an intelligent conversation about what's going to happen. Social Security is not only important to seniors; it's clearly going to be important to our children and our grandchildren, and retirees in the future.

Right now, only one-half the workforce has a retirement plan, a 401(k), and only one-half of those people are putting in the maximum amount. We have a situation where Social Security will never be more important, and the members who are pushing cuts in Social Security claim that they don't want our children or our grandchildren to have this debt. The fact of the matter is, our children and our grandchildren are going to need Social Security. Social Security is so special. It is no investment risk.

Checks go out regardless of the market. Checks went out when we had Katrina. People had to go from Louisiana to Texas; Social Security found those people, and got them their checks. After 9/11, Social Security was there for those people who were left without the breadwinner. It was there in a matter of weeks. The benefits increased, keep increasing to keep up with the cost of living. That's something we have to protect.

> **The average life expectancy has increased for those that are healthy and wealthy... Most people would love to keep their jobs, but can't. Their health isn't there, or the job isn't there.**

I know that this symposium is to find solutions for budget problems. As long as benefit cuts are all that's on the table, I don't see how we can have an intelligent conversation. We should decide what services we want, then figure out how to pay for them. The Commission is going backward, picking an arbitrary funding target and then squeezing programs into it. There's a real disconnect between fiscal hawks and the American people.

The National Foundation has recently paid the University of New Hampshire, which has a very good reputation on poll taking, to take a poll. We found that people absolutely back the Social Security program. We also saw something interesting: people are more willing to pay a higher payroll tax than to cut benefits. Even young people very blithely would say, "It's not going to be there. Millions of dollars have been spent." For the first time, they're worried that it's not going to be there, but they think it should be. We're going to have to start up a campaign again, make cutting Social Security something that we really have to protect against.

So many people, even people who collect Social Security, don't understand the program. We need people who are interested in the future of this country going around, helping us learn about Social Security. It used to be that a newspaper had someone to cover Social Security, but that's no longer true. I was on a panel with a woman that wrote *The Woman That Gave Us Social Security*; it's a wonderful book about Frances Perkins. This woman got a Nobel Peace Prize when she was working at *The Washington Post*. I asked her, "Why did you leave the *Post*? We need you so desperately at this time." She said, "Barbara, I couldn't stand it. They're reacting now to their advertisers, and many of their advertisers are arch conservatives. They're very careful to make them happy."

We must preserve Social Security for future generations. Before I end, a little bit of history: in 1983, I was on the Ways and Means Committee. Because of the way the formula was written, and because inflation had been so high the past years, we had a real problem. We didn't know if those checks were going to go out. We were worried, and we knew we had to do something: the baby boomers were coming. One of the key

Continued on page 8

Kennelly Keynote Address (continued)

people on the Commission now says, "Nobody knew the baby boomers were coming." I don't know what was the matter with him, because they were in their late 20s and in their 30s. We raised that payroll tax, and these people worked all their adult lives, paying into the Social Security system. That surplus was building up so they would be prefunding their benefits. What do you do with that surplus? What better to do than put it in government bonds?

Now we're hearing, "We're not going to honor those government bonds." We hear that Social Security is going flat broke, that the government bonds are worth nothing. Those are government securities, the same as the bonds that we sell to our international neighbors, to Citigroup, to well-off people. Are we being told those bonds will be honored, but not the bonds that people paid into month after month? I don't think so.

The difference between '83 and now is that the people who were on the Commission, and the people who were in the House Ways and Means Committee, believed in the program. They were willing to work hard to make that program work, and they did. The program since then has not only worked; it's built up to surplus.

One of the decision-makers we now have is Representative Paul Ryan. He's got a road map to fix the whole country. One way is to absolutely privatize Social Security. We had that fight in 2005. I watched the President go to 60 cities around the country, and talk about privatization. We kept hoping he'd go to more, because every time he talked about privatization, more people realized, "No, we can't do this." There were a number of reasons against privatization, but the mere idea that the transition costs would be so high meant that the solvency question went unaddressed.

Speaking of solvency, the whole point is fixing Social Security, and our actuaries now say that the program has enough money, if we honor the bonds, to 2037. After 2037, it can only pay 76%. People are acting like all of a sudden, there are no workers. Money is coming into Social Security all the time. Is there a shortfall? Yes. Would I be more than willing to work hard to see that we look at the solvency issue? Yes, but what the Commission says, what the executive order says, is that any savings found in this study of budget problems goes toward deficit reduction. If they raise the cap (which everybody's saying is a good way and probably is a more fair way), the money wouldn't go toward Social Security. It would only make the solvency problem worse; it would go through a deficit reduction.

We have here a real difference of opinion. Those people who were detractors of Social Security, when we began the program, remained detractors of Social Security. They were there in 1983 when we were working on reform. Pete Peterson is a very successful man who made his money in an equity firm in Wall Street. For some reason, he just can't stand Social Security. This year, he gave a billion dollars to the Peterson Foundation, to work toward solving the deficit problem, but really to work hurting Social Security. We should be worried.

I believe in democracy, and differences of opinion. Having studied it, looked at it, heard about it, campaigned against privatization, I also feel committed to future generations – not just to today's retirees – to have a strong social insurance program. Every other developed country has. You hear we're like Greece. Greece had the most unbelievably favorable benefits – much, much too high. We don't have anything like that. Other countries are raising the age. France is having a big fight over raising the age from 60 to 62. Ours is 67 and we're being told that maybe 70 is a good age.

Get involved. Talk to your newspapers, your Congress members. Talk to people to explain that, yes, the deficit is terrible, the debt is terrible, but Social Security didn't cause it. We still need Social Security now and we're going to need it for future generations. I thank you for coming to an event like this, because obviously you care about the future of the United States of America.

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Session Two Summary: Social Security, Medicare and the Budget

Chaired by Sherle Schwenninger

Session Two panel, left to right: Greg Anrig, Harold Pollack, Nancy Altman, Eric Laursen, Sherle Schwenninger

Sherle Schwenninger

Today's second major panel session is on Social Security, Medicare, and the budget. I think one of Jamie Galbraith's major contributions over the last year or two is reminding us to think about Social Security and Medicare. It's very important not only to defend them, but to actually think about their strategic role in helping stabilize the economy, including their long-term preservation of dignity for retirement. In thinking about future budgets as well as recovery, these are the most cost-effective ways to provide retirement security and health security for a large portion of the American population. I think Jamie has done a very good job in highlighting some of the ways that Social Security and Medicare can be utilized in these strategic fashions going forward. I hope that our panel will, in addition to establishing the true record of Social Security and Medicare, give us some ideas about the tactical role of these programs in the future.

Eric Laursen

I'd like to put the current discussion about Social Security into context, and then try to make sense of the role of the President's Fiscal Commission. The Social Security debate is the longest-running domestic political tug-of-war in Washington. The issues involved, and the positions that conservatives and liberals have staked out, are almost exactly the same ones as when Reagan entered office.

This last 30-year period coincides pretty closely with the long period of wage stagnation for American workers. Wage stagnation and health care costs are the major sources of pressures and funding problems on Social Security. More and more of seniors' Social Security checks are being eaten away in health care expenses. In 1970, five years after Medicare was enacted, seniors' out-of-pocket expenses for health care were miniscule. Today they pay an average of a bit more than $250 a month out of a Social Security check that averages about $1100 a month. If the health care system isn't brought under control, Social Security will have to be made more generous because, increasingly, it's specifically a health care benefit rather than a retirement income benefit. Even health care costs would be less of a problem if wages weren't stuck in neutral or declining.

Keep in mind that there are three sides in the Social Security debate. There are the traditional defenders of Social Security who want to keep the basic structure as it is and oppose further erosion of benefits. Second are the privatizers who essentially want to funnel workers' payroll taxes to the financial services industry in the form of private accounts. The third group are the deficit hawks who simply want to cut benefits as much as they possibly can.

The privatizers and the deficit hawks tend to agree that the direction wages have been going for the last 30 years is not going to change, and probably shouldn't. That means income tax and payroll tax revenues are going to trend down over the long-term; that government, including Social Security, is going to have to shrink; that Social Security will have to be cut, and cut, and cut until there's nothing left. The members of the deficit Commission are almost all privatizers and deficit hawks.

The key question is: how much pressure does Social Security place on the economy as a whole? The answer is: not very much. According to the Trustees' latest report, the Social Security deficit (the benefit promises that payroll taxes don't cover completely) over 75 years will come to just .7% of GDP. It's equal to about 1.92% of taxable payroll – small enough that the whole problem could be eliminated by a series of modest boosts in payroll tax that would never exceed the rate of inflation. This is how Social Security was rebalanced in previous years, and it could be done again very easily. This option is off the table with the Deficit Commission.

I suggest that the fundamental problem is a kind of tacit understanding that there's not much to be done about wage growth, or even unemployment in the next few years. This threatens to become a kind of self-fulfilling prophecy. The quality of most American jobs will

Continued on page 10

Social Security, Medicare and the Budget (continued)

continue to decline, wages will continue to stagnate, and payroll tax receipts will dwindle. If that becomes the case, we may find ourselves with a real Social Security crisis, because just as you can't solve Medicare's problems separately from those of the larger health care system, you can't solve Social Security's problems without creating jobs for American workers.

Nancy Altman

Recently, some conservative politicians have argued for cutting Social Security by quoting Willie Sutton, who, when asked why he robbed banks, replied, "because that's where the money is." If one looks at the federal budget only as a unified whole, Social Security does indeed appear to be where the money is. But while examining the federal budget as a unified whole is useful for analyzing broad fiscal policy, it's a distorting frame of reference that ignores that Social Security is a defined benefit pension plan with added life insurance and disability insurance protection, sponsored by the Federal government.

Just as private employers are required to keep company pension plan assets in trust, segregated from general operating funds, so Social Security's assets are kept in trust. If a CEO talked about the company pension plan the way that today's deficit hawks refer to Social Security, he or she would appropriately be accused of seeking to raid the plan.

To ensure that Social Security will always be able to meet all of its obligations, its Board of Trustees employs over 40 actuaries to project the program's income and outgo. Because insurers and pension plans often face a substantial time lag between the receipt of premiums or contributions and the expenditure of benefits, they must, to be prudent, employ lengthy evaluation periods well beyond the normal budgeting cycle of five or ten years. Despite the claims of crisis, the latest Trustees' report shows quite the opposite. It reveals that in 2009, Social Security ran a surplus of $122 billion and had accumulated a reserve of $2.54 trillion which will grow to $4.2 trillion by the end of 2024. For the entire 75-year valuation period, Social Security faces a shortfall of .7% of GDP – about the same as extending the Bush tax cuts for the top 2% of the income scale.

Social Security's benefits are modest, averaging less than $13,000. Despite their modest size, they are vitally important to almost all who receive them. Two-thirds of the elderly receive half or more of their income from Social Security. Nearly 9% of our nation's children receive Social Security themselves or live in households supported by another beneficiary. About eight million disabled workers receive benefits, without which more than half would have incomes below the poverty line. It lifts 19 million Americans out of poverty each and every year.

> **About eight million disabled workers receive [Social Security] benefits, without which more than half would have incomes below the poverty line. It lifts 19 million Americans out of poverty each and every year.**

Cutting benefits further would expose millions of vulnerable people to needless economic hardship. Nor is scaling back or eliminating benefits for higher income workers good policy. That would not only erode support for the program, but those benefits are an important part of retirement income to everyone but the wealthiest.

Let me conclude with a general point. Social Security is better than any private pension arrangement that can be devised. Among other things, it's fully portable, and includes virtually all workers (including temporary workers, part-time workers, and other hard-to-cover workers). Its benefits are fully protected against inflation, and it has many other strengths. It does all of this extremely efficiently, returning in benefits more than 99 cents of every dollar spent. No private arrangement can boast such low administrative costs. The reason that Social Security works so efficiently and well is that, unlike any other entity in our country, it can maintain the broadest investment return across virtually the entire country and prevent all adverse selection.

Similarly, Medicare is able to provide health insurance to the most expensive parts of the population – seniors and people with disabilities – at lower administrative costs than private sector insurance is for the same reason. The most cost effective, efficient, fair, and secure way to provide retirement income for our citizens is to expand Social Security. The same is true for health insurance. We should lower the Medicare age. Instead of talking about cuts, our policymakers should be discussing those options.

Greg Anrig

This panel's assignment was to address ideas that might be different from the sorts of policies often heard during debates over the federal budget. I'm going to discuss just one idea that I believe would be enormously beneficial to many millions of Americans as well as to the overall fiscal health of the country. The idea is to fully federalize Medicaid, the health insurance program for low-income Americans, the disabled, and the elderly who require long-term care.

Since it inception in 1965, Medicaid's management and financing have been shared between the federal government and the states. That arrangement has always been problematic; dividing responsibility between jurisdictions diffuses accountability. Since no one is exactly responsible, problems are left to fester. In contrast, fully federal programs like Social Security and Medicare have over the years been reformed in ways that actually strengthen them. There are many reasons why federalizing Medicaid would improve public health and the cost-effectiveness of our health care system.

The great recession has caused tax revenues to plummet and demand for

Social Security, Medicare and the Budget

public services to soar. Soaring Medicaid costs, rising much more rapidly than inflation, contribute significantly to states' chronic budget squeezing. On top of that, enrollments have increased. Shifting a greater share of Medicaid's costs to the federal government would liberate states from constantly having to cut back on spending for schools, public universities, law enforcement, and many social services.

The good news is that the new health care legislation takes some steps in the direction of federalizing Medicaid. Under the health care bill, Medicaid is the single most important vehicle for extending health care coverage to more people. To make that work, the federal government would pay 96% of the cost over the next ten years. The higher matching rates are obviously intended to induce states to be willing to take on new Medicaid enrollees. However, states will have to determine when the law takes effect in 2014, whether applicants qualified for Medicaid under existing rules in the states as of 2010 or under the new thresholds, etc.

There will be lots of different matching rates for lots of different people. That complexity is going to create confusion and may lead to reforms. The big political challenge will be to persuade deficit hawks that shifting costs now borne by the states to the federal government makes fiscal sense. It does, for several reasons.

Americans have to pay Medicaid's costs one way or another. Because state taxes are much more regressive than the federal income tax, moving toward federalism will shift the cost burden toward those who can most afford it.

Secondly, America's interrelated problems of soaring medical inflation, mediocre care, and a huge uninsured population are an outgrowth of our highly fragmented health care system. Federalizing Medicaid would reduce that fragmentation, giving the federal government much greater leverage to control overall health care costs.

A third benefit is that during recessions, when state-balanced budget requirements would lead to Medicaid cut-backs, the Federal government would have greater flexibility to make sure low-income individuals are adequately covered.

There's no question that the political hurdles to federalizing Medicaid are significant, but this was an idea Ronald Reagan actually supported, and some states' rights conservatives also like the idea, because it would get rid of a federal mandate on states. It would also enable states hobbled by financial pressures to better govern themselves. Federalizing Medicaid has always been a good idea, but the health care bill just might set in motion a political process and rationale for actually making it happen.

Harold Pollack

When people talk about the entitlement problem, they usually mean Social Security, Medicare, Medicaid, and increasingly public employee pension and health benefits are being thrown into the mix of the discussion. In my view, only Medicare is on a fundamentally troubling fiscal path. Even here, I would say that the projections reflect broader issues of health policy. Medicare management faces complicated problems of public management and political economy, and we mis-specify things when we frame the challenge as one of reining in an overly-generous entitlement.

The CBO has identified 30 ways to address what I consider to be a quite manageable funding gap. My personal favorite is to eliminate or to greatly raise the ceiling on taxable earnings, which would cover about 90% of the funding gap, smarter policy than trying to cut benefits. I especially favor raising the cap to increase benefits for specific populations. A lot of people on Social Security live on quite modest means; if anything, benefits need to increase for those people. More and more people have to take early Social Security benefits, which as they get into their 70s and 80s will be very punishing. Cutting the benefits is really not something I would welcome.

I will just say that Greg is entirely right about Medicaid, that the wrong level of government is paying, and states are groaning under the load. In-adequate provider reimbursement and recession-bound states cutting benefits are symptoms of a program whose financing structure is wrong. The essential challenge is not cost control, either in the short run or the long run; it's getting the right fiscal structure to pay for it.

Continued on page 12

Social Security, Medicare and the Budget (continued)

Regarding employee benefits, a lot of states have created a genuine problem with the financing of public employee benefits. We have $100 billion unfunded liability in Illinois and a state income tax that's a flat 3%. If we raised it to 5%, we would actually cover the entire unfunded pension liability. There have been problems with governance and managing these pensions, but they're so much less important than our failure to have proper tax policy. I think that's true at the federal level as well.

Let me close by focusing a little closer to home. Six years ago, my mother-in-law basically dropped dead without warning, leaving my wife Veronica and me to care for my wife's mentally-disabled brother. We put him in our van, and drove him 770 miles from his home in Oneonta, New York, to the upstairs bedroom where he lived right next to our two young daughters.

He's been hospitalized many times. He went through spells of around-the-clock home IV treatments. He moved in weighing 340 pounds. Moving him across state lines severed his links to Medicaid and to every social service that he had been receiving for many years. I'll just say that pretty much every public benefit was really, really screwed up, and we had to reapply for everything that he had been getting.

Two things were not screwed up and continued seamlessly – his Social Security and his Medicare. It took a ten-minute visit to the Oneonta New York Social Security Office to take care of those things, which have continued without a problem to this day.

It's still quite a challenge. My wife had to leave the work force to take care of him. There were some significant financial repercussions from that, so Vincent's $1100 a month Social Security check was really quite important for our family in managing this challenge. It now allows the funds for him to live in a nearby group home two miles from our house.

I should mention this benefit comes from the terrific, though unknown and badly named, "Disabled Adult Child Program" that's part of Social Security. You may not think about it much, but each of us, if we work, has a nearly $500,000 life and disability insurance policy that accrues by paying into the trust fund. No product like this exists or probably could exist within the private market – certainly not to the father of an intellectually disabled child with a genetic condition. Yet it's quite feasible to do this within the Social Security structure at very minimal cost, administratively or otherwise.

In some ways, I would say I'm at the moderate among those in this room today regarding some long-term deficit issues, but I strongly, strongly identify with our common purpose. Programs require tinkering, but they're neither unsustainable nor a drag on the economy. Quite the opposite: they provide a level of security and stability that benefits us all. I would say in closing that my experiences over the past six years reinforce something that I should already have known: that social insurance protects every one of us against life's risks that could crush any one of us if we had to face it alone. We need to protect that, and we need to recognize that activist government is not something we do because it's nice for other people; it's something that can benefit all of us.

Keynote Address

James K. Galbraith

Keynote speaker James Galbraith

The two major panels that have already spoken have very eloquently given us a graphic portrait of the economic issues that we face and of the threats to Social Security and Medicare which are inherent in the present tenor of the economic debate. They've also described with very moving testimony the value of these programs. I must say I was particularly touched by Harold Pollock's family story.

It is important for those of us who are often critical of the social protections in this country to recognize that these programs are successes, and they're successes by any standard. They are the greatest social policy successes that we have known in the history of this country, the most enduring. I think if you make a careful comparison, they are also successes by the standard of comparison with countries we often compare ourselves with. They are large, stable, social policy achievements on a continental scale that has not been achieved elsewhere in the world.

This morning I want to address a very specific aspect of the debate, and to do so as an economist. I want to ask whether the fear of long-term deficits should legitimately be used to justify proposed cuts in Social Security and Medicare, and for that matter, whether that fear of long-term deficits stands as an effective obstacle to the entire project of a new strategic direction for economic growth and recovery. To address that question, I need to say a few words about the work of an institution that is justifiably an icon in this city, one of the very few respected, non-partisan and professional organizations we have – the Congressional Budget Office. Its work is used as the foundation for much of the debate over the future fiscal position of the United States.

The CBO has an important professional function, and everybody who has

Galbraith Keynote Address

been on the Hill, as Congresswoman Kennelly and I have, understands what that is. It is to provide a fair evaluation of the budget costs of particular legislative proposals. Its fundamental job is to permit people to make proposals, and to have them come back costed in a way that is trustworthy, transparent, and consistent. In order to do that, there needs to be a common set of baseline economic projections to provide that standard of consistency. For that purpose, however, it is not necessarily important that the baseline forecast be realistic as a projection of what the economic future is going to be.

So long as it's consistent and everything is being judged by the same yardstick, then the internal consistency of that forecast is a secondary consideration. But those forecasts are being turned and used for a much different purpose: to describe for us all the fiscal future of the United States. As those forecasts are presently constructed, that future looks to many people to be extraordinarily scary, with the public debt spiraling out of control. It is important to ask whether the forecasts are realistic. For that we have to ask, how does the CBO make that forecast?

First is to assume away our current economic difficulties over a period of time; that is to say, assume that the economy will recover from the recent crisis and recession. Generally over a five-year horizon, we return to a relatively low rate of unemployment. To get there, we have a relatively rapid rate of growth. If this were to happen, it would be great; we'd all be in favor of it. If it were to happen without any changes in policy, it would be wonderful; we would all be delighted.

Of course with economic recovery, people would resume paying income taxes and the deficits would fall, as they did in the 1990s, when we moved to full employment and the budget went into surplus. The problem with this as a projection of the actual future is the one already given at the start of this program by Tom Palley, which is the growth model that got us to full employment in the late 1990s, and that got us closer to full employment in the 1980s; a model based upon the very rapid expansion of bank credit for various purposes in the late 1990s, the drive for information technology investment, and in the 2000s, for that matter, the housing bubble. That model is broken. The institutions that underpinned that form of growth are not going to be able to do it again. The institutions themselves remain deeply impaired by the effects of the crisis, and they don't have customers. They don't have households with equity they can borrow against.

> **[The growth] model is broken. The institutions that underpinned that form of growth are not going to be able to do it again. The institutions themselves remain deeply impaired by the effects of the crisis...**

They don't have businesses who are out there trying to find credit for business expansion.

We are not going to return to full employment by any automatic process. However, having assumed that we are, the CBO then recreates very large deficits with a new series of assumptions that kick in after the effects of economic recovery are felt. One of them is runaway healthcare costs, and the assumption that the worst things that could happen in that sector are going to happen. I'll leave that one aside for the most part. Another, which is very important, is that there will be a return to what are historically very high real interest rates – a nominal interest rate on short-term money of about 5% (with a 2% inflation rate, or a real interest rate on short-term money of 3%, as opposed to the present levels, which are negative 1.5%–2%), so a 4%–5% shift in the short-term real rate of interest, the rate that applies to government debt.

Another thing that happens as a consequence is an enormous run-up in the net interest payments of the federal government, running up to fantastic values, 20% and plus of GDP in 25 or 30 years, which is an expenditure item on the federal budget. These things are supposed to happen in conjunction with a very low rate of inflation – 2% – with the result that debt in comparison to nominal GDP spirals out of control. That is where the long-term budget deficit and debt projection comes from. Are there weak points from the standpoint of an economic realist in this projection? I think there are two major weak points.

One is that it is extremely unlikely that the Federal Reserve will return or would return to a high short-term real interest rate in the absence of a rise in inflation. There's no reason why they would take that step. If they did, it would have catastrophic effects on business investment. It most likely would precipitate back into recession.

There's very little historical precedent for such a policy. There was one stage in the postwar period when we had 3% real interest rates, 4% real interest rates with a 2% inflation rate; that was the late 1990s. It wasn't true in the'50s and '60s; it wasn't true in the 2000s. The '70s were an unstable period in which the inflation assumptions didn't apply. Those 1990s years were very different from our present situation. There's no logical reason for that assumption to be there, but it generates an enormous part of this deficit debt dynamic.

The second problem is that those interest payments are public spending; they have to go to somebody. We're not wiring them to Mars; we're sending them to people who hold US government debt. That's going to show up as income on those people's accounts, income that would amount to three or four times the total of present defense spending, in relation to GDP – vast sums that look like the mobilization for World War II more than like anything else, although they're not going for anything particular except checks into people's bank

Continued on page 14

Galbraith Keynote Address (continued)

accounts. Assuming that the money would be spent – some of it would be – the inflation projection is surely out the window. If the inflation projection's out the window, the debt to GDP ratio isn't going to look like they project it's going to be.

My position, my argument, is that much of the debate on this issue is based on a mirage, hidden inside technical assumptions the CBO has made. These are not terribly damaging for most of the purposes, but are completely inappropriate for a serious discussion of the actual fiscal position of the United States and its actual economic condition. That's not to say that we aren't likely to have large deficits going forward. We are, but those large deficits are likely to be due in the future for the same reasons that we have them today: an underperforming economy, a very high rate of unemployment, and relatively low tax take in comparison to what it would be at potential. That will be accompanied not with high but with continuing very low interest rates, with different implications for the debt.

This suggests that when you think about this problem coherently, the long-term policy problem is the same as the short-term policy problem: it is to create jobs and to place the economy back on the footing of stable prosperity. That is the desirable objective per se, and something that will require a sustained effort, a new strategic direction (as well as comprehensive reform that has not actually occurred and is not sufficiently addressed in the reform bills of the financial sector), to make it once again an effective, functioning part of the economy. That's the correct strategy, as I said, not only for economic growth and the condition of the economy in the medium- and long-term, but also for the funding of Social Security and Medicare.

As has been argued very effectively in the earlier panels, the major problems with Social Security and Medicare's funding is low wage growth and inadequate employment; there are not enough people paying the payroll taxes at present rates. Fix that problem. Then the other problem, to the extent that it is a problem, goes away.

Suppose it were true that even large public debts were associated in general with low economic growth in countries whose conditions were comparable to our own. That would be the case because those countries do not have an effective growth mechanism generated by the private financial sector, so that they do not have a credit system creating jobs and enabling people to pay taxes that cover the services that the public sector provides. These two problems are integrated; they cannot be separated.

The prescription cannot simply be cutting the public sector's interventions in the economy. It has to be to repair the other side of the balance sheet. That has to be the first step in a strategic proposal for the economy...

The prescription cannot simply be cutting the public sector's interventions in the economy. It has to be to repair the other side of the balance sheet. That has to be the first step in a strategic proposal for the economy – to recognize that the private sector is important, that it has taken a colossal hit in the last three years as a result of a colossal mismanagement in the previous fifteen or so, and that the reconstruction of a functioning private financial sector that serves our economic purposes is an indispensable priority.

What are the other components of the program? It seems to me that we ought to recognize right now that we have an ongoing housing crisis. The problems of home mortgage finance – and for that matter, of mortgage fraud – are being compounded by a vast new industry of practically automated foreclosures, driving hundreds of thousands of people out of their homes on the basis of incomplete and shoddy documentation. This is an emerging social crisis, and stabilizing people in their homes is an emerging and hugely important social priority for stabilizing jobs, neighborhoods, local property tax revenues, and an entire infrastructure of the American economy.

Part and parcel of that, extending from it very slightly, is the step that's already been discussed this morning on a number of occasions: the need to stabilize the budgets of states and localities for the duration of the crisis. There is no reason why, in an economic downturn, we should tolerate the destruction of public schools, of police and fire forces, the closing of libraries, the non-maintenance of parks. These are services on which people rely, on which they fall back in hard economic times, and it's just an artifact of the way we structured things that they're under such pressure. There's no economic reason why they should be. Steps should be taken to take this problem off the books. Heather Boushey made a political argument as to why Democratic Congress doesn't want to help Republican governors. Fine, do it the other way: take Greg Anrig's suggestion and federalize Medicaid, and there will be a flow of funds that will go to the states and localities that will help deal with that problem.

We need to think about how the national economy can be made to grow. It seems to me that the important concept here is once again encaptured by the word "strategic." We need a strategic policy imparting a new direction to economic growth. We have had, broadly speaking, recognizable strategies in the past. In the postwar period, we created a broad middle class that was largely home-owning; institutions achieved this. In the late 1990s, we created a very large, effective and internationally successful information technology sector, in part through a drumbeat of public promotion of the importance of these technologies. I don't think there was a day in the Clinton-Gore administration in which the President or the Vice President didn't talk about the importance and value of those industries.

Galbraith Keynote Address

What is it going to be in the future? We have to address our energy challenges, our climate challenge, and that part of the fact that doing so involves the reconstruction of the country. That is to say, we need to give people choices about the way in which we produce and use energy. For that, we need to rebuild our infrastructure.

There are many other things we could do to rebuild our common public capital in a way that the private sector knows can be sustained. We need to have both public and private investment moving down this road. That is a reason for enacting a national infrastructure fund: to create an institution akin to the reconstruction finance corporation, and akin to institutions that have existed and still exist in many countries around the world. It would give the private sector confidence that there will be a sustained effort in this direction, that their investments, in which they are staking their own money, have a good chance of paying off.

The same can be said for jobs programs. The programs should be put in place, focused on goals and objectives that meet our immediate needs, providing hope for progress toward solving the country's actual economic and environmental problems – not temporarily, but permanently.

Another thing is getting up to scale, and moving toward a recovery program that the public perceives as making a difference in a relatively short period of time. One element should be wholesale measures that will affect a large number of people in a short period of time, if they work. There's been some discussion of having a payroll tax holiday for this purpose, to give a major injection of funds into working American families, which they can use to rectify their balance sheets, improve their consumption. I supported the President's decision to take a proposal that originated in the Reagan tax cuts, a major tax break for business investment. Even though this is a vast subsidy to capital, if it works, the idea is that business investments will pick up, and there will be a reciprocal effect of firms' investment activities stimulating the investment activities of other firms, thus beginning to move from a vicious to a virtuous cycle of economic growth.

Even if we do all of that, the crisis we have experienced has been profound beyond any of our professional experience. We have lost more jobs, and people have stayed out of work longer, than in the '70s or the '80s, or in the recession at the end of the millennium. We've lost eight million jobs. Many of those have been lost by older workers for whom work is hard, not people like me who speak from a microphone and sit in a chair, but people who stand up behind cash registers with back braces year in and year out.

We have to recognize that looking for jobs for many of those people is an exercise in futility and will be so until they are ready for Social Security, because there will always be a younger or a healthier person who's better for that job, and who actually needs the job more in many respects because they're starting out rather than finishing up. This is why we should consider another wholesale measure: reducing the age of eligibility for Social Security and Medicare.

I suggest that we create a window, the way universities do when they need to get rid of an ineffective professor. At the age of 62, for the next three years, people could retire with full benefits. It should allow people for whom that's a good deal, people for whom work has been hardest, to take it up.

Someone asked earlier, "What do you do for the older workers who still want to look for jobs?" This is one thing. Other workers who still want jobs would find it easier to get them, if they weren't competing with this enormous pool. In addition, younger people would find it easier; there would be more openings. The unemployment rate would come down, and the whole population would be on a happier, more rational footing in a very, very early stage. The same would be true if the age of eligibility for Medicare were reduced to 55. Allow people who have medical issues, but who are holding onto their jobs just because of their insurance, to move on, if they want to.

We hear the opposite proposal, for cuts in both of these programs, and I would bet it will take the form of further increases in the retirement age. We've talked about the consequences of raising the retirement age to 70, up to a 40% cut in the lifetime stream of benefits for those who, for one reason or another, are obliged to take early retirement. This is justified on the very shallow grounds that the average life-span of the population is lengthening – a fact which is only the case because we've been paying people successfully under Social Security and Medicare to live longer; a real example of successful economic incentives, if you ask me. The fact is that

Continued on page 16

EPS Fellow Jurgen Brauer has converted his monthly columns into blog format. The columns - written monthly since August 1997, and irregularly since the mid-1980s - are first and foremost extensions of his classroom. But he now invites students worldwide to join him in the writing of columns, ordinarily less than 800 words in length. Email ideas to brauer.jurgen@gmail.com.

***Mr. Broder's war and economic myths*, by James K. Galbraith, November 3, 2010 in The Washington Post.**
EPS Chair James Galbraith published a letter to the editor of The Washington Post in response to David S. Broder's editorial, *The War Recovery?*
To read the letter, see http://www.epsusa.org/publications/jamie_letter_wapo_nov10.htm.

Galbraith Keynote Address (continued)

the increase in life expectancy doesn't apply to the bottom half of the income distribution; it's much less for those who actually work hard in their working lives.

That policy is a particularly invidious, dishonest, and cruel way to approach whatever is done about Social Security and Medicare. I want to stress that it has also very adverse economic effects. It would make unemployment worse by requiring people to hang onto jobs that they would otherwise happily give up in favor of other applicants and contestants for those jobs.

Without having gotten back to full employment, doing this simply congests the labor queue, creating problems which will afflict younger workers for their entire lives, as they experience long periods of job search and unemployment before they get that crucial first job. Overall, there will be less demand, less growth, and the economy will not meet the needs of its actual population. Poverty will be greater under these proposals. All of this is unnecessary and avoidable. It is certainly not justified by the argument that we face somehow a long-term, very-hard-to-specify in any concrete sense problem with the funding of the United States government.

If you could pin deficit hawks to a wall (which I would very much like to do), and get them to try and tell you what it is that they are worried about, what would such people say? I think the only thing they would say is that with the United States government soaking up capital funds, there would be less available for business. If there's less available for business, that means the cost of funds for business must be much higher. That will show up in the interest rate.

We have to ask, do all of these people from Wall Street know what they're talking about? Have they looked at the interest rate lately? The capital markets are in some ways the arbiter of this. Are the capital markets afraid that the United States government is going to run into difficulty paying off its debts? Are they unwilling to lend to the US government because they fear a rising rate of inflation?

The answer is: not in the next 30 years, not over the longest term of debt that the US government presently issues, where the interest rate has been falling, and is now at practically historical lows – 3.6% for 30 years the last time I looked. We have, I think, a refutation. It's not the most conclusive bit of evidence, but it is a fairly strong refutation, that the problems (that appear on a superficial glance in the budget projections of the Congressional Budget Office) are actually taken seriously by people who have money – their own money, and other people's money – on the line.

There's been a good deal of talk of the sustainability of Social Security. The point has been made that very small adjustments in payroll tax formulas would cover the actuarial deficit of the Social Security trust fund over 75 years. Even if this were not the case, even if there was a substantial difference between what the payroll tax is expected to take in and what Social Security is expected to pay out, the programs would still be sustainable.

> **Social Security... assures that those who do not have families that would otherwise support them get a payment anyway, on the basis of their past contributions to the system.**

What is it that Social Security and Medicare actually do? You cannot separate the public effect from the effect on private finances. Social Security provides a benefit, a payment, to the elderly population, survivors and dependents, which in some respects replaces payment that those who have families who are prepared to support them would otherwise make. It assures that those who do not have families that would otherwise support them get a payment anyway, on the basis of their past contributions to the system. The payroll tax likewise assures that you make a contribution, whether you have parents you would otherwise support or not.

When thinking about this, assuming that we don't want the elderly population to get out of the way by dying off, the major transfers in both halves are not from the young to the old. They're within the elderly population, from those who would otherwise have means to those who don't, and within the working population, from those who would otherwise not have burdens, to those who otherwise would. In economic terms, both of those transfers occur in the present. They are not matters that pass back and forth across time. They both can be sustained indefinitely. They are also fair. They are generous in the broad sense of that term; that is to say they are wise, they are just. And they give us a society which is vastly happier than it could ever otherwise be.

In Session One, Mike said that his Medicare does not benefit society. I guarantee you it benefits your children and your grandchildren. They don't have to worry about the specific consequences of something that might happen to you, in terms of the medical cost, and otherwise would be worried greatly about it. Medicare spreads the risk over all of us, which is what we should properly be doing. Again, there is no financial impediment along those lines.

Congress will face recommendations, the first of December, from a Commission of very doubtful judgment and fairness. It seems to me very important that Congress take the message from this panel, and from all of our efforts, that it should not panic, that it should not be panicked. They're not facing any form of an emergency that requires action in the lame duck session – action which on mature reflection, we would only come to regret.

We need to continue discussing these issues, continue the process of educating the American policy elites about what the American public already knows: that these programs are stable, they are successful. They are a vital element in the design of a successful strategy for economic growth and recovery going forward.

Session Three Summary - Defense and the Budget

Chaired by Michael Lind

Session Three panel, left to right: Linda Bilmes, William Hartung, Heather Hurlburt, Lawrence Korb, Michael Lind

Michael Lind

Our final session is "Defense and the Budget." During the Cold War years, defense as a percentage of US GDP was about 6% on average. It spiked up to 15% or more during the Korean and Vietnam Wars, then went down to about 3% around 2000. Recently, it's risen to nearly 5%, about 4.7%. Add various off-budget spending, black programs, and so on, it's probably well over 5%, 6% of GDP. Yet despite all of the talk about the fiscal crisis and budgetary problems, discussion of defense and its relation to the rest of the budget has been curiously missing.

As we know, when President Obama announced a freeze on discretionary spending, he specifically exempted defense spending. The purpose of this panel is to look at defense and its relation to the civilian budget and the overall budget, and to explore various questions. How big should the defense budget be? Apart from the question of overall numbers, what should the composition of spending be? What should the focuses of foreign policy be?

Ultimately, the discussion of the defense budget has to be within the context of some sort of vision of American grand strategy going forward, after the Iraq and Gulf Wars. We'll also be addressing the costs of those wars, and of ongoing military operations and the health care costs associated with them. This is a major contribution, in my opinion, to the discussion about the federal budget in the years and decades ahead.

Linda Bilmes

I want to start off this conversation by asking whether wars are an efficient way to achieve our strategic defense objectives.

Since 2001, the wars in Afghanistan and Iraq have cost us more than a trillion dollars in cash, which is the very top-of-the-line visible expense. Since 2001, the defense budget has also grown by a trillion dollars, over and above war appropriations. We estimate that at least 25% of that amount is related either directly or indirectly to the wars in Iraq and Afghanistan.

We know that wars have a long tail, and the cost of wars continues for a very, very long time. For example, the peak year for paying disability compensation for World War I veterans was 1969, more than 50 years after armistice. Based on historical patterns, the cost of treating Iraq and Afghanistan veterans over the next 40 years was initially expected to be between $400 and $700 billion, depending on the length and intensity of the wars. This current war is expected to be much more expensive than previous wars, both in disability compensation and in medical care. With medical care, in particular, we have a much higher survival rate with 95% of those who are seriously wounded surviving, compared to around 50% in previous wars; a much higher level of noncombat injuries, a much higher incidence of mental health disease, such as PTSD. We now expect that the cost will be between $500 and $900 billion, as the numbers of those who have been treated and have filed for disability is much higher than expected.

These costs do not include many of the other costs, such as subsidized housing loans, burial benefits, family benefits, vocational benefits, training benefits, and the GI Bill, which we support. When you add those together, we come to at least a trillion dollars of veterans' benefits just from the current wars. There are also extensive social-economic costs for veterans and their families. They also exclude the macroeconomic costs, such as the impact on the oil price – it was $25 a barrel when we invaded Iraq, and it rose to $140 a barrel at the peak of the war in 2007.

In any analysis of the current wars, the bottom line is that you pretty much reach a minimum of $4–, $5– or $6 trillion that we've spent. The question is whether that is an efficient expenditure to get rid of a dictator that you don't like, as we did in Iraq. The benefits can be debated, but the costs are not debatable.

I have two recommendations. First, we need good accounting on what wars actually cost in order to have transparency on what is actually truly being spent in defense and national security. Currently, the spending is fragmented across the Departments of Defense, Energy, Veterans, Homeland Security, State, Labor, Housing, and elsewhere. We really have no idea what the real costs are. Second, we need to change

Continued on page 18

Defense and the Budget (continued)

the way we analyze conflicts so that the costs are taken into account and fully estimated at the beginning of a conflict. We need a smarter way to achieve defense objectives, so that we are not eroding our economic security in order to achieve objectives related to military security.

Lawrence Korb

I have been working with Bill Hartung and Heather Hurlburt on the Sustainable Defense Task Force to propose a number of reductions for the Deficit Commission to consider. As you might expect, we've gotten an awful lot of pushback, calling us an awful lot of names.

We are briefly going to explain the recommendations that we made to the Commission. I'm going to outline some of the personnel reduction, Bill will get into the hardware, and Heather will get into the politics of the whole thing.

No matter how much is spent on defense, it would not guarantee perfect security. We suggest that by implementing these reductions, we still will be very, very, very secure.

I'll start with the personnel costs. Whatever you think about the wars in Iraq or Afghanistan, these are the first significant conflicts in our history where taxes were not raised. In fact, they were cut. That is one of the reasons for the deficit; the other is we didn't have conscription, so the cost of military personnel has been driven to astronomical levels. In terms of personnel, we should do a couple of things.

First, why do we still have 150,000 troops in Europe and Japan? The Europeans are cutting their defense budget to deal with the deficit, because they can basically be free-riders. We, too, can cut back and take troops out of the force. Secretary Gates said in Foreign Affairs, "We will never do Iraq and Afghanistan again; no more nation-building under fire." If that's the case, roll back the strength of the Army and the Marine Corps to where they were before we got involved in these conflicts. About 100,000 people at a cost of close to $150,000 per person would save about $15 billion.

Then, of course, the most controversial recommendation: military pay and health care benefits. Every four years, the Pentagon has what they call a Quadrennial Review of Military Compensation. The 2008 review found that DoD is using the wrong metric to decide on pay raises every year. Base pay is not really the total value of compensation. Military personnel get free healthcare, don't pay for retirement, and get a whole bunch of other benefits. The Pentagon's own review found that $55 billion could be saved over the next ten years, just by adjusting pay according to full military compensation.

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Similarly, with a military health care plan (and we're talking about retirees now, we're not talking about people on active duty), there are about nine million retirees and their dependents who have access to a plan called TRICARE, with premiums that haven't gone up since 1995. We should change that; for retirees, means test it. Raise the premium gradually to about $1100 a year, which is not bad for a family, and save another $50 billion.

The answers are there. The question is whether we have the political courage to do it. Will the Pentagon take the lead and make it easier for the Congress? Right now, nobody seems to want to take these issues on.

William Hartung

It is true that if you're concerned about the size of the budget, you have to look at the Pentagon. This year, its budget is about $738 billion, not counting Homeland Security, veterans' benefits, and some other military-related items. It's about the same size as Social Security. About two-thirds of growth in discretionary spending since 2001 has come from military spending. It's a huge budgetary concern, a huge component of the budget.

It's also true that the United States is now spending almost as much as the rest of the world combined on its military, which was not the case during the Cold War. There's some question as to whether that is really needed. Where is all that money going? Who are the enemies that would justify that level of spending? The Pentagon's own accounting says that we've spent a projected $159 billion for the wars in this current year, so there are hundreds of billions of dollars available to be cut that have nothing to do with the troops in the field. I think people who don't want to cut military spending try to confuse that. They try to say it's all for the troops, and how could you possibly cut military spending during wartime?

For example, the United States Navy is larger than the next thirteen navies in the world combined, and eleven of those navies are US allies. By 2025, the United States will have 1700 fifth-generation fighter jets, top of the line, the most sophisticated in the world. China will have literally a handful. We have 300,000 troops overseas, many of which are not involved in the wars. Given all of that, it seems reasonable that we could cut back or stabilize the Navy; we don't need to rush ahead pell-mell with a new fighter plane program. If we cut back on troops overseas, we would cut back also on military bases and other supporting services.

In the Sustainable Defense Task Force report, we looked at a number of items in the procurement budget. In terms of the cuts proposed, I believe that a determined administration could win these battles. There are a lot of weapons systems in this current budget that aren't related to the wars we're fighting, that don't seem to relate to threats we face in the future, and that therefore are ripe to

Defense and the Budget

be eliminated in any new budget plan. The Joint Strike Fighter, the Expeditionary Fighting Vehicle (which is supposed to help do marine landings we haven't done in 50 years or more), and the Trident Submarine ($6 billion a copy) could easily be canceled.

I think ultimately, we're going to have to limit missions, and that the most important limit is what Larry mentioned: not fighting wars of counterinsurgency, not fighting wars of occupation. That also would have a whole different effect on the trajectory of military spending.

Heather Hurlburt

I want to circle back to where Linda started, with a slightly different view, to ask what the current military budget buys us from a political standpoint.

First, a bipartisan bet is being placed that we can use our military (and endlessly expanding military spending) to avoid coming to terms with a world that is complex and driven by globalized economics. This is in either the hope or the appearance that with hardware we can buy what we can't deliver for ourselves through global markets.

Second, the bet ties into the notion that we can use the military to hold the clock back, allowing us to retain the virtues of our continental isolation and our post-World War II military and economic preeminence.

Third, our military budget represents a hedge, used at various times by both political parties, that defense spending is perceived by the public and the media as a symbol for seriousness about public security. I think many of us on the progressive end of things thought that we had defeated that demon in the '06 and '08 election cycles. The bad news is, like the character in Halloween, it's back.

To that end, the Pentagon and Congress have bound themselves together in a codependent relationship with soldiers' pay and benefits as just one excellent example. The Pentagon sends its annual budget to Congress with a pay rate increase. Then Congress increases pay, goes back and says, "We're taking care of the troops. My opponent over there, whoever he or she is, is not taking care of the troops." Our task force actually did include some suggestions about slowing the rate of increase. I must say, the most bipartisan reaction to the report has been was running away from it.

Having laid all that out as a set of bad news, there is actually some good news on the political front. Three critiques are relevant.

One is what I'll call the Sieve Mill Balance Critique, which is simply that we have one very expensive hammer in the Pentagon, and we've made the whole world into a nail. We've chronically under-resourced state, USAID, Treasury, all of our implements of national power that don't involve guns. That, then, becomes an argument for shifting resources, and in some cases, a net cost-saving argument.

Second is a more technocratic critique: the Pentagon is spending money on the wrong things, on expensive toys it doesn't need. Similarly, the debate over the romance of high-tech continues. This is where the administration has actually scored a couple of modest but significant wins, ending programs that bipartisan forces of reason had been trying to end, in some cases for a decade or more. The technocratic critique has more attraction that it has ever had, I think.

Third, there's the broader economic critique, that the fundamental source of our military strength is our economic strength. Ultimately, you can't have a strong military sitting on top of a bankrupt country. A number of people who want to affiliate themselves with the Tea Party are also taking up this critique.

There are a couple of recommendations. One is that there has to be a real willingness to be politically confrontational on this issue in order to take on the military budget and still seem serious about national security. The other is that we need a new language of cost in which to articulate the trade-offs between economic and strategic costs.

ABOUT THIS ISSUE OF EPS QUARTERLY

On October 1, 2010, EPS hosted **"A Strategic Policy: Investment, Social Security, and Economic Recovery,"** a half-day symposium in Washington DC. The event was co-sponsored by the New America Foundation and the Ronald Reagan International Trade Center Washington DC. This issue of EPS Quarterly offers summaries of the panel sessions and keynote speeches.

Find speakers' biographies, complete transcripts, and video including questions and answer sessions when you visit our website at **http://epsusa.org/events/1010conf/ssprogram.htm.** Be sure to check out other links from our home page: **www.epsusa.org.**

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EPS Quarterly
EPS c/o the Levy Institute
Box 5000
Annandale-on-Hudson, NY 12504
USA
Tel: +1 845.758.0917
Fax: +1 845.758.1149
Email: info@epsusa.org
www.epsusa.org

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Annual meetings of the Allied Social Sciences Association and American Economics Association

January 6–9, 2011 in Denver, Colorado

EPS will host two sessions

January 7, 2011 2:30pm, Sheraton, Plaza Court 1

Pressures on the Paradigm

Panel Moderator:
James Galbraith (University of Texas - Austin)

Marshall Auerback (Madison Street Partners, LLC)
Robert Johnson (Institute for New Economic Thinking)
William K. Black (University of Missouri - Kansas City)
L. Randall Wray (University of Missouri - Kansas City)

January 8, 2011 2:30 pm, Sheraton, Majestic Ballroom

Afghanistan - Costs and Exit Strategies

Panel Moderator:
Michael Intriligator (University of California - Los Angeles)

Thomas Schelling (University of Maryland)
Roger Myerson (University of Chicago)
Linda Bilmes (Harvard University)
Lloyd J. Dumas (University of Texas - Dallas)

January 8, 2011 6:30pm

EPS Dinner Honoring Thomas Schelling

Please regisiter by emailing Thea Harvey
at theaharvey@epsusa.org

There will be a memorial session for EPS Trustee Walter Isard on Saturday, January 8 at 10:15am. Speakers from EPS and Peace Sciences International will remember our long-time friend and supporter.

A complete (preliminary) program of the conference is online at http://www.aeaweb.org/aea/2011conference/program/preliminary.php/