I am delighted to join you today and privileged to associate myself with your effort to bring our fiscal house into order.

Let me say at the outset that I remain proud of the economic policies of the Reagan Administration, which laid the groundwork for a record 24 out of 25 years of real GDP growth beginning in 1983. And, like Ronald Reagan, I believe that our problem is not that Americans pay too few taxes but that our government spends too much.

But I also know that a broad bipartisan agreement – a “grand bargain” if you will – will be necessary to reduce our deficits and stabilize our debt. And any such bargain will require something that has become, I regret to say, a dirty word in today’s Washington: “compromise.”

I will not go into the domestic consequences associated with continuing on our current path, except to say that they would be catastrophic. As a former Secretary of the Treasury and Secretary of State, let me focus instead on the international aspects of our fiscal crisis before mentioning a few of the elements I believe should be part of any grand bargain.

Right now, we are enjoying a period of extremely low interest rates and, therefore, manageable debt service. This will not continue indefinitely. In a real sense, our debt is a ticking time bomb. As the U.S. and world economies recover, interest rates will rise. And lenders – many of them foreign – will begin exacting a premium for lending to a government with total federal debt at over 100 percent of GDP for as far as the eye can see. What is
happening to Europe today is a cautionary example. When a sovereign debt crisis hits, it can strike overnight. When it hits the United States, the Federal Reserve will likely respond by raising interest rates and/or monetizing the debt, creating the groundwork for a period of low growth, high inflation, and a plunging dollar.

Such a state of affairs could imperil the traditional role of the U.S. dollar as the world reserve currency. This would increase instability in international markets, dampen global growth, and constrain the ability of our government to pursue an independent monetary and fiscal policy.

More generally, our fiscal crisis runs the risk of undermining U.S. leadership abroad. There will be increasing – and understandable – calls to reduce our expenditures on defense and diplomacy, constraining our ability to respond to a world where both threats and opportunities abound. In the final analysis, U.S. strength abroad depends upon our economic health at home. And our fiscal crisis threatens both.

So, what should a grand bargain look like? Let me suggest a few broad principles.

One – any plan should be realistic. The idea, for instance, that we are going to solve our budgetary problems simply by raising taxes on the affluent is a total fantasy. The so-called Buffett tax, for instance, is projected to raise less than $50 billion over ten years – a fraction of one percent of total expenditures over the period.

Two – any plan should strike a pro-growth balance between revenue increases and spending. The Simpson-Bowles plan – with a ratio of expenditure cuts to revenue increases of roughly three to one – could be a plausible starting point for discussion. My own preference would be for a plan more weighted towards cuts.
Three -- any plan should include up-front expenditure cuts. There should be no tax increases until spending cuts have already been made or have been legislated. Of course, I am cognizant of the importance of avoiding a fiscal contraction during a period of weak economic performance. Nonetheless, it is critical that there be a substantial “down payment” in terms of spending cuts. Otherwise, we – once again! – run the risk of raising taxes while deferring tough decisions on spending – and never see the agreed upon spending cuts. (Fool me once, shame on you. Fool me twice, shame on me.)

Four -- any plan should have a spending cap that establishes strict spending targets. Our current high government spending to GDP ratio of 24 percent is, admittedly, at least in part, a result of the economic downturn. But we need a spending cap to bring this number down to a sustainable level as the economy recovers. Simpson-Bowles suggests a medium-term goal of 21 percent of GDP. Again, I believe this to be a good starting point for discussion, though I would prefer a lower number.

Five -- any plan should include an enforcement mechanism to guarantee that the spending cap is met and maintained. Why? Because absent a strong enforcement mechanism, a future Congress can simply disregard the provisions of any bargain. This is particularly true when it comes to spending. There will always be good reasons – on political grounds, if not economic ones – to spend more.

As the most effective enforcement mechanism, I have long supported a balanced budget amendment to the constitution, but one with an overall limitation on the ratio of taxes to GDP. However, given political realities, we probably will have to be satisfied with a legislative approach.
For example, something along the lines of a beefed up Gramm-Rudman-Hollings provision that would ...

.... mandate automatic sequestrations should we exceed our target spending cap....

.... and that would mandate sunset provisions terminating all tax increases included as part of the grand bargain should total federal spending exceed the target percentage of GDP.

Further, it should feature supermajority requirements in both houses of Congress to repeal or change any elements of the grand bargain.

Lastly, any effort to raise revenue as a part of the grand bargain should focus on broadening the tax base rather than raising marginal rates. I realize that comprehensive tax reform may be a “bridge too far” in the current political environment. I speak as someone who remembers well the difficulties we faced in forging bipartisan support for even the “revenue-neutral” tax reform of 1986. If our objective, however, is to reduce our ratio of debt-to-GDP and restore growth to our economy, any revenue we raise should be raised by closing loopholes rather than by increasing marginal rates.

Am I sure that such an approach will work? Let me be frank: given the polarization of American politics, I am far from confident that a grand bargain will even be struck. This is particularly true if we continue to experience divided government, a very possible outcome of the November elections.

That said, I believe it critical that Americans of good will – Republicans, Democrats, and independents alike – do all we can to press our elected officials to make the compromises, however painful, that are necessary if we are to set our country on a sustainable fiscal path. The alternative – permanent political gridlock, a lower standard of living for our citizens, and a much diminished place for the United States in the international arena – is simply unacceptable. Let
us make no mistake about it: our task is a difficult one. To succeed, we will need to keep our eyes on the prize: a future in which our citizens can flourish at home and our country can protect its interests abroad.

Thank you.