

# Over the Cliff: Alan Simpson and Erskine Bowles on the Looming Deficit Crises

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by Michael Skocpol

As President Obama and Congressional leaders hurtle Thelma-and-Louise-style toward a budgetary precipice, another deficit-tackling duo hit the road earlier this month to deliver a simple message: This all could have been avoided.

Pushing their plan for reigning in deficits before big automatic spending cuts and tax hikes drive the economy over the so-called “fiscal cliff,” the two men – former Senator Alan Simpson, a Wyoming Republican, and Democrat Erskine Bowles, who served as White House chief of staff under Bill Clinton – spoke to advisors on Nov. 15th at the Schwab Impact conference in Chicago, discussing the current budget crisis and their long-term concerns for the national’s fiscal health.



Alan Simpson and Erskine Bowles

Simpson and Bowles are best known for co-chairing Obama’s 2010 bipartisan Presidential Commission on budget reform. Though the commission’s so-called “Bowles-Simpson” plan failed to garner unanimous support from its members and went unheeded by Congress, the two men made clear that they still hope both parties will come around to their approach.

In their remarks, the duo cast themselves as practical thinkers pedaling a common-sense cure for our national’s fiscal ills in a Washington that is hogtied by partisan bickering and unable to embrace practical solutions. Both Simpson and Bowles said that Americans should be alarmed and infuriated that leaders in Washington haven’t gotten serious about

budgetary reform until the last few weeks.

The stakes, they said, are high – including the possibility that the country could plunge back into recession early next year.

Perhaps sensing an easy target, they painted a dim portrait of Congress, chastising it for its failure to enact any bipartisan plan – especially theirs. In their view, the Bowles-Simpson plan failed not on its merits, but because spineless and self-serving politicians on both sides of the aisle, unwilling to look past the next election to forestall a looming crisis, were too short-sighted to perceive its bipartisan brilliance.

There’s plenty of reason to believe that Simpson and Bowles are being uncharitable – and perhaps a little self-serving themselves. Before addressing their diagnosis of the immediate situation in Washington, however, let’s first review what they see as the five big challenges to the nation’s fiscal health, what they’d like to see done about them, and why they worry that – fiscal cliff or no fiscal cliff – we can’t afford to wait any longer.

## The five horsemen of the debt-pocalypse

Simpson and Bowles sounded a warning that we’ve all heard many times before – the US, they argued, is on a trajectory toward an unsustainable financial future, and the problem will only get worse over time if we don’t address it sooner rather than later.

Bowles laid out the five major drivers of budgetary imbalance that he and Simpson believe any long-term fix must address:

1. The first and biggest problem Bowles identified is runaway health care spending. According to Bowles, the U.S. spends twice as much as any other developed country on health care, but ranks between 25th and 50th when it comes to important criteria like life expectancy and preventable deaths.

“In 1981, we spent 10% of the budget on health care. Today we are spending 25% of the budget on health care. By 2020 we will be spending a third of the budget on health care, and it won’t be long before all we can do is take care of a couple of old coots like me and Al,” Bowles said. “Health care is by far number one.”

Simpson said that the recent health care reform legislation, whatever its pros and cons, did not seriously address the problem of rising costs. “There is no cost containment in this baby until down the road,” Simpson said. “And you know what they will do down the road? Nothing.”

2. The second problem we must confront, according to Bowles, is defense spending, an area where US spending is even more out of whack with the rest of the world – America, he said, spends more than the 17 next-largest countries combined.

“We are bearing a disproportionate responsibility for global world peace,” Bowles said.

3. Third, Bowles argued that the tax code is a mess. “We have the most inefficient, ineffective, globally anticompetitive tax code that any man could dream of,” Bowles said.

The earmark spending that budget hawks commonly complain about – meaning targeted outlays of federal funds – total a relatively slight \$16 billion dollars per year, Bowles said, but our convoluted tax code obscures many times that amount – \$1.1 trillion annually – in hidden backdoor spending, which he dubbed “tax earmarks.”

4. Bowles cited Social Security as the fourth-biggest long-term challenge. He noted that when Franklin Roosevelt created the program, the average person lived to age 63, and the Social Security retirement age was 65. “Today, average life expectancy is 78, and you get Social Security at 62,” he said. “We have an arithmetic problem.”

Simpson later elaborated, citing the familiar problem that well-documented demographic challenges – retiring baby boomers and lower birth rates – are squeezing the system’s funding base. In 1950, he said, 16 people paid into the system for every one retiree, and that ratio is expected to fall to two-to-one a decade from now.

5. Finally, Bowles pointed to a problem that he said would be particularly familiar to the advisory community – compound interest. The US already spends \$230 billion on interest payments on its debt each year, enough to fully fund six of the biggest cabinet Departments, he said, and those costs could rise to an overwhelming \$1 trillion by the year 2020.

Taken in combination, Bowles said, these problems will have dire consequences for our ability to invest in important national priorities if we do not address them in a comprehensive way.

“This is not a problem we can slowly grow our way out of,” Bowles said. “It’s not a problem we can slowly tax our way out of. And, I wish it was, but it is not a problem that we can slowly cut our way out of without really disrupting a very fragile economic recovery, or without hurting the truly disadvantaged, or without making such severe cuts in two things” – education and infrastructure – “that America must invest in if we are going to compete in the knowledge-based global economy.”

### **A bipartisan plan that met bipartisan inaction**

Simpson and Bowles, of course, were there to remind the audience that their commission already formulated a plan that they feel addresses all these problems in a bipartisan way.

Numbers tend to get squishy – a trillion here, a trillion there – when Washingtonians discuss budget hypotheticals, but, by its authors’ accounting, the Simpson-Bowles approach calls for about \$3 trillion in various spending reductions over the course of a decade, and about \$1 trillion in new revenues.

On the tax side of the equation, Bowles said they’d achieve the revenue increases by eliminating all of those “tax earmarks” he referred to (easier said than done?), then using 8% of those savings – about \$100 billion per year – to pay down deficits. The remaining 92% would go toward pushing down income and corporate tax rates across the board in an effort to stimulate growth.

The tax aspect of the plan – which bears some similarities to the approach advanced by Mitt Romney during his losing presidential campaign, albeit with more specific figures and fewer debatable promises about its effects – has been among the most controversial elements of the plan, particularly on the left. Nobel Prize-winning economist and *New York Times* columnist Paul Krugman has led the charge, saying that Bowles-Simpson is “obsessed with lowering marginal rates despite a complete absence of evidence that this is important.”

Simpson, meanwhile, highlighted the commission’s proposals on Social Security, which he argued make reasonable, incremental – and necessary – changes, such as increasing the amount of income subject to Social Security taxation to at

least \$190,000 and raising the retirement age to 68 by the year 2050, another proposal with which Krugman – not to mention the AARP – takes issue.

Bowles and Simpson mostly eschewed pushing the specifics of their plan, however, and held it out first and foremost as proof that bipartisan compromise is possible on these issues. They stressed that 11 of the commission's members, including Congressmen generally regarded as quite liberal and quite conservative, signed on to the bill.

They did *not* mention the fact that seven of the 18 members of the commission voted against the plan, which meant that it fell well short of the 14-vote super majority that could have guaranteed a vote on the bill in Congress.

Without any teeth behind it, the proposal went nowhere. Instead, Congress appointed its own "Supercommittee" to try to forge a compromise of its own, the failure of which precipitated many of the automatic cuts (known as the "sequester") and revenue hikes Congress is now grappling with today.

### **The tipping point**

Simpson and Bowles seemed frustrated that it has taken the artificial crisis of a self-imposed fiscal cliff to create any sense of urgency around these issues. They blamed a prevailing sense that the problems their plan tries to fix are long-term, not immediate. And, implicitly, they seemed to feel that this was one reason why their commission's plan was not acted upon.

It was an impression they focused on dispelling throughout their remarks.

With deficits running as high as a trillion dollars per year, the debt is steadily growing, and Simpson stressed that it's impossible to know when all that straw will finally break the camel's back.

Regular readers of *Advisor Perspectives* are well aware of the running debate over exactly when debts become so unsustainable that they begin having truly pernicious influence on the economy at large. In particular, Carmen Reinhart and Keith Rogoff's theory that this inflection point has historically occurred when debts surpassed 90% of GDP has gotten a lot of publicity, as we are near that threshold currently.

Simpson didn't weigh in on that debate, but his remarks did suggest that we as a country should find that uncertainty much more troubling than we currently do. "The tipping point could come in two years, one year, two months, or two days," Simpson warned.

Bowles stressed that the ill effects of the problems he and Simpson joined the commission to address are not distant concerns, and even older Americans should be clamoring for solutions. "We really thought we were doing it for our grandkids," he said. "But the more we looked at the numbers, the more we came to realize we weren't doing it for our grandkids, we were even doing it for our kids, we were doing it for us."

### **What lies on the other side of the fiscal cliff?**

Everyone is now staring over the so-called "fiscal cliff," as Ben Bernanke has christened the toxic casserole of indiscriminate spending cuts, automatic tax hikes, and expiring legislation that is scheduled to hit at the end of the year. Urgency has arrived in Washington, though Bowles and Simpson remain irked that it didn't get there sooner.

"If any of your businesses were facing the kind of results that we are facing now, and you knew it was going to happen in less than 50 days, you would have everybody in your company working on it – and you would have for the last year," Bowles said.

Both men stressed that the fiscal cliff, for all the publicity it has gotten, is not overhyped. Bowles described it as "\$7.2 trillion of economic events that are going to hit America right in the gut," a worrisome problem that, if anything, the two parties are not taking seriously enough.

Even those who take heart in the thought of a much leaner federal government, Bowles said, should not want the kind of "mindless, senseless, across-the-board cuts" that are scheduled to take effect. "There is not one of you in here that would recommend to their clients that they invest in a company that is just doing their cuts across-the-board," he added.

Given his concern that Congress and the president put off dealing with the problem until after the election, Bowles was pessimistic that an effective compromise can be struck in time. At the time they spoke, a little less than two weeks ago, he pegged the chances that the two sides will reach a successful resolution to the situation before we reach the edge of the cliff at about one in three.

Simpson noted that there is sentiment growing in both parties to go over the cliff, in hopes of finding a stronger negotiating stance on the other side. Simpson called the momentum building behind that viewpoint, which he said puts party politics before the nation's welfare, deeply worrisome and a reflection of the flawed priorities that predominate in Washington.

If we do ultimately take that plunge, Bowles said, there would again be about a one-in-three chance that the two sides would quickly reach a compromise and undo the worst effects of the cliff. But, he said, he's worried there's an equally high probability that both sides will dig in even further, and things will spiral from bad to worse in a hurry.

"The market hasn't priced this in," Bowles warned. "And if the market finds that we can't govern and we can't get together, and they see this recession coming on, and the lack of growth, they are going to kill us. The market is really going to go down."

That would lead to a "vicious cycle" of business cutbacks and deflating consumer confidence, as well as ratings downgrades to U.S. debt, Bowles said. He estimated that, in that event, economic growth would fall by about 3% – more than enough to bring about another recession – and unemployment will spike back to about 9%.

### **Who shot the Bowles-Simpson plan?**

Anyone could be forgiven for leaving Simpson and Bowles' remarks wondering why their plan never gained more traction. Simpson and Bowles' portrayal of themselves – as cogent, responsible do-gooders fighting a losing battle against a relentless tide of political self-interest and rigid ideology – makes for a tidy narrative designed to pluck heartstrings.

But their claim to have found a magic elixir of bipartisan compromise that both parties will eventually be able to swallow is undercut by the fact that six of the 12 representatives and senators on the commission, including future vice presidential nominee Paul Ryan, voted against its final recommendation.

Simpson and Bowles' message throughout – advanced with varying degrees of circumspection – was that the various Congressmen and -women who didn't throw their weight behind the plan are small-minded cowards who won't risk losing their own jobs in order to secure a more prosperous future for the nation.

But – even as Simpson found an easy target in the unnamed, generic Congressmen who he called "pathetic" for not supporting compromise on the debt – he went out of his way to say that he and Bowles were "very impressed" with Ryan as a creative and courageous thinker on these issues. Yet Ryan was among the conservative faction within the Bowles-Simpson commission that concluded the final plan was unwise.

So Bowles and Simpson may be as susceptible as the rest of us to a famous paradox in political science: Even as polls find Congress as a whole to be less popular than communism, when people are asked at the ballot box to send particular representatives – *their* representatives – back to Washington, they overwhelmingly tend to do so.

That mass of "blood-sucking insects," as Simpson jokingly called politicians, often become serious thinkers with substantive objections when considered on their personal merits – no matter how satisfying it may be to play to the general stereotype. I doubt Simpson thought he himself was a brainless parasite when he got reelected to the Senate twice.

A similar conundrum has long handcuffed voters' thinking about budgets in general – Americans love the idea of smaller government, but start asking them about specific government functions, and many programs start to look a lot more untouchable. This phenomenon – Americans tend to be "ideological conservatives and operational liberals" – has been well-documented for decades.

That might explain why, during the presidential campaign, both Barack Obama and Mitt Romney tried to embrace the spirit of Bowles-Simpson and appropriate its mantle as their own, but neither was actually willing to sign on to the letter of the plan.

Obama in particular remained conspicuously neutral at the time the plan was announced. It's been argued that he had no choice, because Republicans would have savaged the plan if he'd been too closely associated with it, and some would say he's been quietly coming around to certain parts of Bowles' and Simpson's approach. But there are also clearly **big differences**, and a centerpiece of Obama's reelection campaign – raising tax rates for the wealthiest Americans – diverges unmistakably from the rate-lowering approach advanced by Simpson and Bowles.

You can argue that was an opportunistic, political call on Obama's part, given that he was facing a tax-shy multimillionaire in the general election. But no one this side of famed anti-tax crusader Grover Norquist would deny that raising taxes is one way to meaningfully reduce the deficit, and a clear majority of the electorate seems to agree with Obama's approach. If rate

hikes for the wealthy were the specific form of revenue increase around which Obama was able to mobilize an electoral majority, who are Simpson and Bowles to say that their approach is somehow better or more workable?

In the end, it is likely that whatever compromise is eventually struck will pay lip service to the work of Simpson and Bowles, and it may well appropriate certain parts of their plan. But the solutions that our leaders are willing to adopt are going to be those they can persuade the public to support.

Expect everyone to continue to love the spirit of Bowles-Simpson a lot more than they do its nuts and bolts.

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