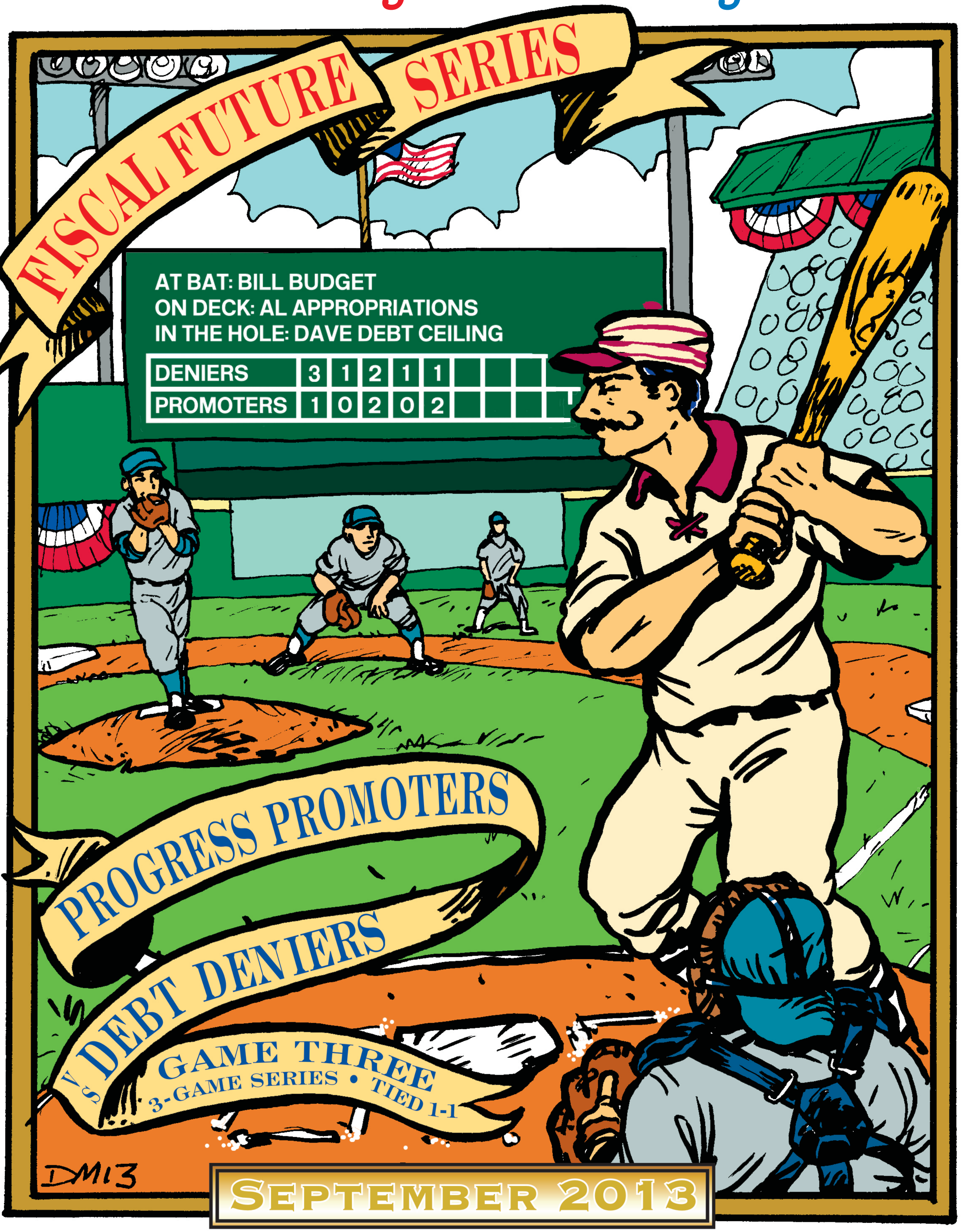
America's Deciding Game: Winning the Future



About

CAI is a 501(c)3 non-profit organization that promotes fiscal responsibility and sustainability by engaging the public and assisting key policymakers on a non-partisan basis to achieve solutions to America's federal, state and local fiscal imbalances. The Hon. David M. Walker is the Founder and CEO of CAI. Dave Walker is a former U.S. Comptroller General and head of the Government Accountability Office (GAO) (1998-2008), as well as a former Public Trustee of Social Security and Medicare (1990-1995).

The Comeback America Initiative (CAI) wrote this report to outline what has happened in connection with the nation's fiscal challenges since 1991, and more importantly, to outline what needs to happen in the future in order to achieve a fiscal "grand bargain." This publication also serves as a capstone report of CAI's efforts during its three-year lifespan.

The information in this report is based on a variety of sources. Numeric fiscal and economic information is from the Congressional Budget Office (CBO), the Government Accountability Office (GAO), and other authoritative sources. Qualitative information is based on a variety of reliable sources, including feedback gathered during the extensive and unprecedented public engagement activities of CAI and its Founder and CEO. For example, since September 17, 2003 Dave Walker has given speeches or participated in events in all 50 states, Washington, D.C., and several countries. These included events during the Fiscal Wake-Up Tour, conducted in partnership with the Concord Coalition, the Brookings Institution, the Heritage Foundation, and others, traveling to over 50 cities between 2005 and 2007, and featured in the critically acclaimed 2008 documentary *I.O.U.S.A.* While leading CAI, Dave has given speeches at almost 350 public events in over 35 states and in Washington, D.C. to an estimated attendance of over 100,000. In the fall of 2012, Dave led the $10 Million a Minute Tour, which consisted of over 30 events in 16 states and Washington, D.C. Over the years, many millions have received Dave's messages on television and the radio and in print and online.

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Executive Summary

Baseball fans experience a range of emotions in September when pennant races are in full swing, with the ultimate outcome determining which teams will play in the World Series. Yet baseball is only a game. In contrast, the implications of decisions grappled with by Washington policymakers in September often have wide ranging implications for our nation, particularly when it comes to the federal government's finances. As this report makes clear, the implications of our nation's deteriorating financial condition could not be more consequential. In fact, whether or not the U.S. will create a better future for our children, grandchildren and future generations will largely be determined by when and how our nation's structural deficits will be addressed.

Given baseball's popularity, this report uses a baseball analogy to reach a broader audience of people not normally inclined to read about the federal government's finances. This report is about the "Fiscal Future Series." Since fiscal year 1991, the U.S. has been engaged in this short three-game series, which pits the Progress Promoters against the Debt Deniers. The Progress Promoters are those who want to face and fix our fiscal mess, while the Debt Deniers are the forces that want to continue to kick the can down the road in connection with tough fiscal choices.

Major legislative agreements and an unanticipated economic boom in the 1990s resulted in the Progress Promoters winning Game 1 (FY1991-1999) after achieving a budget surplus, and with public debt as a percent of GDP having declined by about 7 percentage points during the nine year period. However, they were soundly defeated in Game 2 (FY2000-2008) due to multiple, unforeseen obstacles and a number of self-inflicted errors. For example, 2003 was arguably the most fiscally irresponsible year in the history of our nation, whereby Congress and the President passed additional tax cuts despite the fact that deficits had returned, enacted additional and unfunded Medicare entitlements, and began a new war that was charged to the nation's credit card.

Achieving victory in Game 3, which began with the full onset of the "Great Recession", is more difficult than ever. To win requires a comprehensive approach—addressing short-term economic challenges, while simultaneously beginning to address the even more serious structural deficit and debt challenges that lie ahead. Victory involves devising and implementing a comprehensive spending reduction and revenue enhancement plan that will result in additional economic growth and more jobs, coupled with a lower and more sustainable level of public debt as a percent of GDP, well into the future. As it currently stands in September 2013 we are part way through Game 3, and the Debt Deniers are winning. A continuing resolution to fund the government for the early part of fiscal 2013-2014 appears likely, and the threat of another debt ceiling fight looms.

Game 3 isn't over yet, and a win is still possible for the Progress Promoters. However, the current odds seem to be against them. There is growing pessimism and "fiscal fatigue" in Washington and around the country regarding the ability to reach a fiscal "grand bargain." This is dangerous, for the budget deals reached in recent years have generally only tackled the relatively easy stuff – lowering caps on discretionary spending and raising taxes on the wealthy. This combined with the political calendar—with 2014 being an election year, quickly followed by

the start of the 2016 Presidential campaigns—makes it quite possible a grand bargain could be out of reach until 2017 absent a market forcing event. The political system is also working against progress; it is no longer representative of or responsive to the public, which prevents action on our fiscal and other key sustainability challenges.

Washington must address the key drivers of our structural deficits - aging demographics, rising health care costs, and an outdated and inadequate tax system. Failure to do so impacts the economy both today and tomorrow. For example, poorly designed fiscal policy in recent years, such as the sequester, has already harmed the economy. A grand bargain that couples longer-term reduction of debt as a percent of GDP with timely and targeted investments to further stimulate the economy and create jobs would set the government on a sustainable fiscal path, provide businesses with needed certainty, and increase consumer confidence. If we continue on our current course, interest and mandatory spending will crowd out other productive investments, including investments in young people. The sooner such action is taken, the less drastic reforms will need to be, allowing elements to be phased-in over time, giving individuals and businesses more time to adjust. And the sooner we act, the quicker we stop mortgaging the future of our children, grandchildren, and future generations with a burden they did not create, but will ultimately end up footing the bill for.

Victory is possible for the Progress Promoters, but it requires a well thought out and implemented game plan. Here are seven key strategies for achieving this victory:

1 - A Realistic 2013 Objective

2 - Change the Way We Keep Score

3 - Build Upon Successful Public Engagement

4 - Broaden the Message to Include State and Local Financial Challenges

5 - New Fiscal Strategies Inside and Outside the Beltway

6 - Address the Leadership Deficit

7 - Fixing Our Dysfunctional Democracy

Read the report, “America’s Deciding Game: Winning the Future” for more details about these seven strategies. We can and we must win the Fiscal Future Series to create a better future for America.

Introduction

The pressure is mounting, and the stakes could not be higher. Baseball fans experience a range of emotions in September when the pennant races are in full swing to decide which teams will play in the World Series. Everyone wants their team to win, but, in the final analysis, baseball is only a game. The winner does not have significant implications for the country or for most Americans. By contrast, the decisions grappled with by Washington policymakers in September often have wide ranging implications for our nation, particularly when it comes to the country's financial condition.

Of course, this is not a report about baseball; it is about whether or not the U.S. will create a better future for our children, grandchildren and future generations. But our baseball analogy is helpful and appropriate because our national pastime has bonded generations of Americans—and we need to engage a similarly wide audience in order to address our fiscal challenges. By using the analogy we are in no way trivializing our fiscal challenge, and we have sought to ensure this report is written in a fact-based, professional, objective, non-partisan, non-ideological, constructive and solutions-oriented manner.

This report chronicles events and policies that have affected our nation's fiscal health, with special emphasis on the time period from fiscal year 1991 through the present—the critical time span we are calling the Fiscal Future Series. It also highlights the efforts of the Comeback America Initiative (CAI) and its Founder and CEO, the Hon. David M. Walker, former Comptroller General of the United States (1998-2008).

The U.S. has been engaged in the Fiscal Future Series since fiscal year 1991.[i] The Progress Promoters, those who want to face—and fix—our fiscal mess, are playing the Debt Deniers, the forces that want to continue to kick the can down the road in connection with tough fiscal choices. It's a short three-game series, but with high stakes for all Americans. Despite the odds, the Progress Promoters won a very impressive victory in Game 1 due to a solid performance by Presidents George H.W. Bush and Bill Clinton and a generally supportive Congress. Unfortunately, despite a strong start in Game 2, the Progress Promoters suffered an embarrassing defeat, due, in part, to a poor performance from President George W. Bush and lack of adequate support from the Congress.

Currently, the two teams are in the midst of Game 3. It is the final and deciding game, and if the Progress Promoters can pull out a victory, America will be headed down a more prudent and positive fiscal path. America's future position in the world, standard of living at home, national security, and potentially its domestic tranquility are all at stake. If the Progress Promoters don't win, the future will be very uncertain, and our best years could be behind us.

Right now the Progress Promoters are losing Game 3. The Debt Deniers have a sizeable lead due to a variety of factors, including the poor economy and failure of elected officials in Washington to achieve a meaningful fiscal "grand bargain," despite their many opportunities to do so. President Obama has yet to meaningfully address our structural deficit and debt

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[i] Throughout the report, we reference the Federal Government's fiscal year, which runs from October to September. For example, Fiscal Year 1991 was from October 1, 1990—September 30, 1991.

challenges, and the Congress has generally been unsupportive. However, the outcome of the game is far from decided, and the Progress Promoters still have a chance for victory. After all, if the Boston Red Sox can win eight games in a row to win the American pennant and the World Series in 2004, America can pull out a victory too!

What would victory look like? It involves devising and implementing a comprehensive spending reduction and revenue enhancement plan that would result in additional economic growth and more jobs, coupled with a lower and more sustainable level of public debt (as a percent of GDP), well into the future. Realistically, it will involve more investment and reduced spending on consumption, combined with additional revenues that are achieved in a manner consistent with certain principles and values. Additionally, for several reasons, many of the needed spending, tax and other policy changes will have to be phased-in over time.

This report offers a game plan to ensure the Progress Promoters' victory, but first we need to examine past events and understand how the U.S. has gotten to this point.

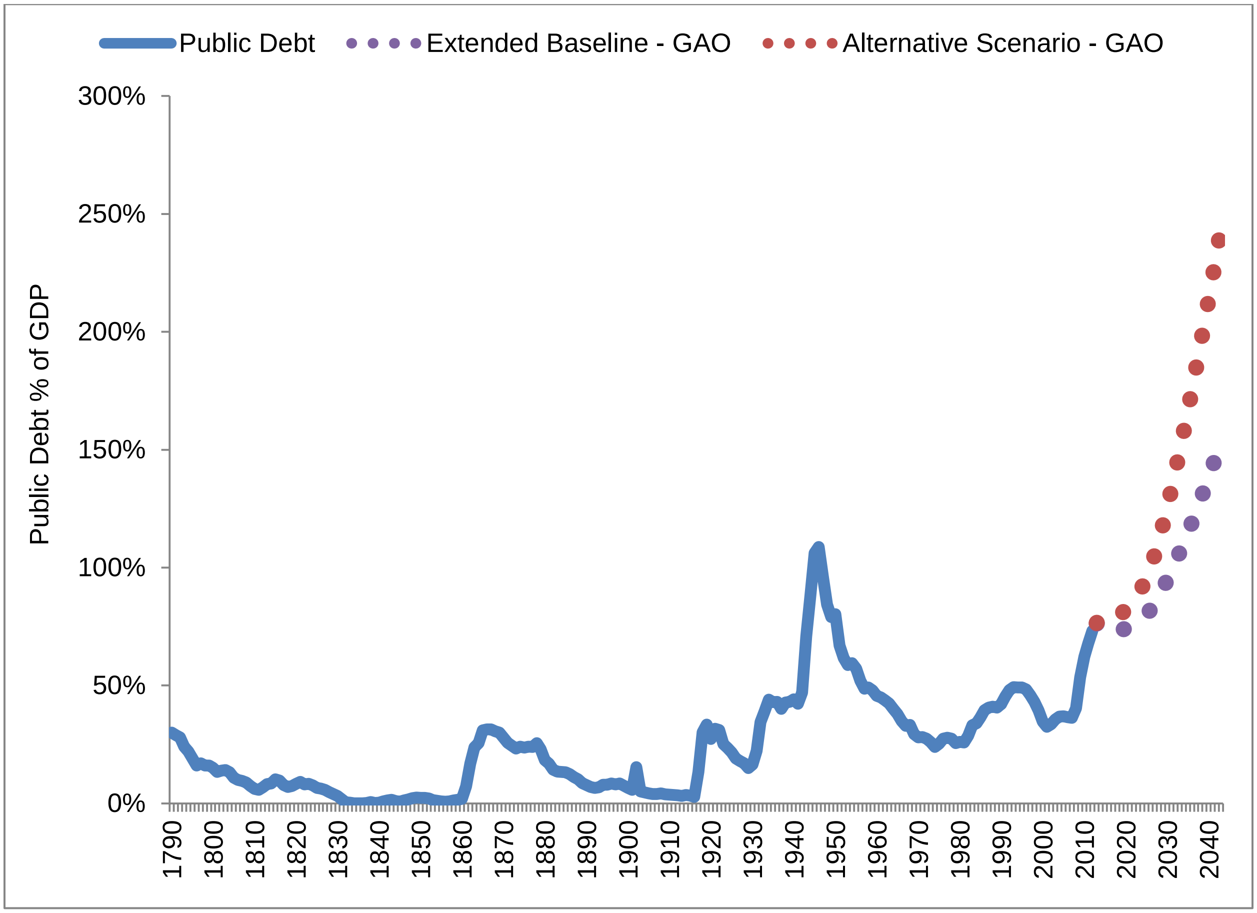
Series Recap

As the Fiscal Future Series began, the Soviet Union was collapsing, which ended the Cold War and made the U.S. the sole superpower for the first time in our nation's history. But this power raised the question of whether or not the U.S. would continue to prosper or suffer the same fate of other great powers that achieved a dominant status, only to lose it over time. Would the U.S. be able to rise to the occasion, maintain its status, chart a different course, and be the first republic to stand the test of time? The ultimate winner of the Fiscal Future Series will in large part answer that question.

Of course there were many fiscal related events in the decades since our nation's founding and leading up to the 1990s that set the stage for the series. In fact, policymakers have been focused on the need to act responsibly with regard to our nation's finances going back to the founding of the republic.

As Figure 1 on the next page shows, our elected leaders practiced fiscal responsibility for more than the first 100 years of our nation's existence. Spending was largely balanced with revenues with the exception of times of war and major national emergencies, after which steps were taken to reduce relative debt burdens (i.e., public debt as a percent of GDP). This cultural norm changed in the later stages of the twentieth century with the emergence of consistent peace-time deficits, and by the end of the Cold War, deficits reached a tipping point (For a more in depth description of major fiscal developments from 1789-1990 see Appendix 1).

Figure 1: U.S. Federal Government Debt Historical and Projected



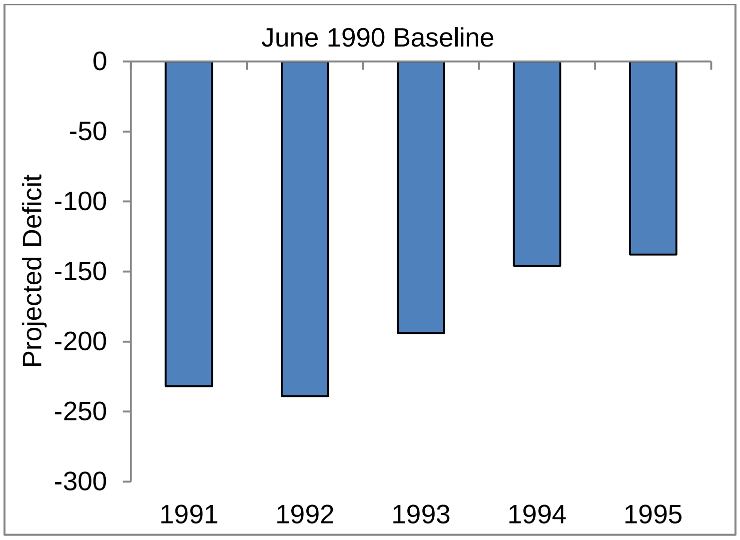
Source: GAO, Long-Term Fiscal Outlook, April 2013; CBO, Historical Data on Federal Debt Held by Public, July 2010

Game 1: FY1991-1999

The Progress Promoters faced unprecedented challenges and opportunities in the early 1990s. The fiscal challenges were daunting, with escalating deficits and mounting debt burdens projected for several years, as shown in Figure 2. In addition, the budget rules established in the prior decade[1] set specific deficit targets, which, if not met, required a sequestration (automatic across-the-board spending cuts). The "Gramm-Rudman-Hollings" Act rules allowed for a deficit of $63 billion in fiscal year 1991, but projections in July 1990 showed a deficit of more than $230 billion, requiring sequestration of a very large and unreasonable amount.[2] (On reflection, this sounds very similar to today's state of play, and as Hall of Famer Yogi Berra once said, "It's déjà vu all over again.")

These fiscal challenges were enough to threaten the economic future of the nation. Therefore, the Progress Promoters set out with a *goal to win Game 1 by achieving a balanced budget for the first time in over a generation. The Progress Promoters also aimed to keep public debt as a percent of GDP at a reasonable and sustainable level because, as a metric of success, it is the most important and arguably the hardest to manipulate.*

Figure 2: Projected Deficits FY1991-1995 (As of July 1990)



Source: CBO "Budget and Economic Outlook: An Update," July 1990

The Progress Promoters prevailed and won Game 1 by a large margin. The first budget surplus since 1969 was achieved, and public debt as a percent of GDP declined by about 7 percentage points between the beginning of fiscal year 1991 and the end of fiscal year 1999. Public debt as a percent of GDP was also projected to decline substantially more thereafter.[3] This achievement was due to a variety of factors (See Table 1 on page 11).

Several major legislative agreements reached by Congress and the President over this time period were of critical importance. The Budget Enforcement Act of 1990, signed by President George H.W. Bush, was part of a $500 billion deficit reduction plan over five years that established discretionary spending caps and "pay as you go" rules for both taxes and spending.[4] The package also raised taxes, and while it took political courage to sign, it also contributed to the President's re-election defeat.

The 1992 presidential election was also significant because of the emergence of H. Ross Perot's campaign, which focused on large deficits and the growing national debt. Perot's campaign brought much greater attention to the issue and opened a national discussion regarding the threat posed by the nation's current fiscal path. While Perot did not win the election, he did receive 19 percent of the popular vote. Perot is a shining example of someone who loves his country and family. He ran in order to help change the terms of the public debate and to help chart a better course for the future.

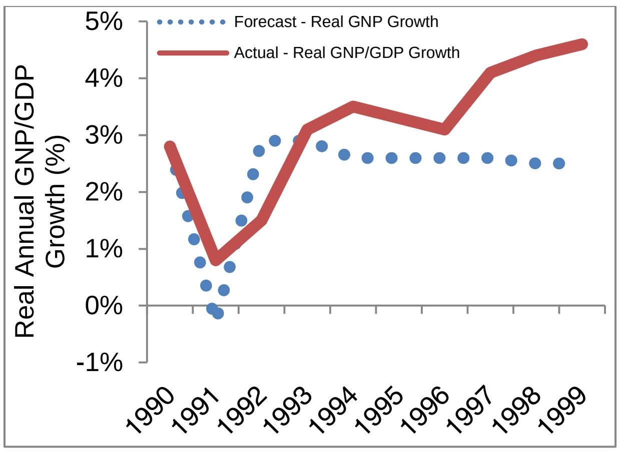
Perot did not win, but he clearly made a difference. His success in gaining public attention impacted the policy agenda of President Bill Clinton, who made addressing the deficit a top priority. President Clinton reached several budget agreements with Congress, including in 1993 & 1997, both of which helped lead to a surplus.

Aside from these legislative achievements, the biggest factor on the game outcome was the unanticipated economic boom that occurred during the latter part of the decade.

As shown in Figures 3 and 4, actual economic growth and unemployment were much more positive than forecasted at the start of the decade. As a result, public debt as a percent of GDP declined at the end of the period, as shown in Figure 5.

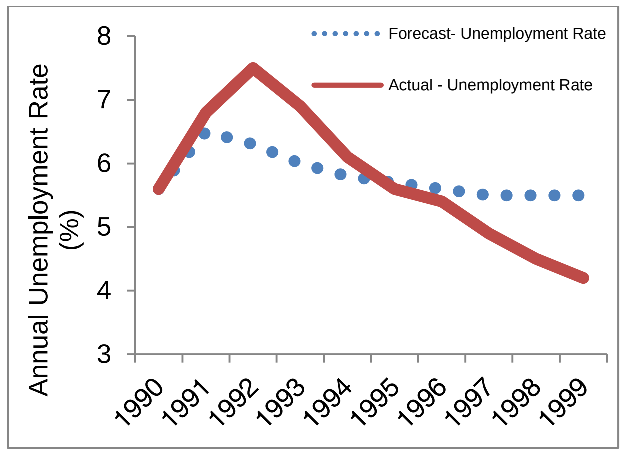
This combination of policy changes and economic changes contributed greatly to the positive fiscal outcomes towards the end of the decade, as shown in Figure 6.

Figure 3: Economic Growth: Projected vs. Actual



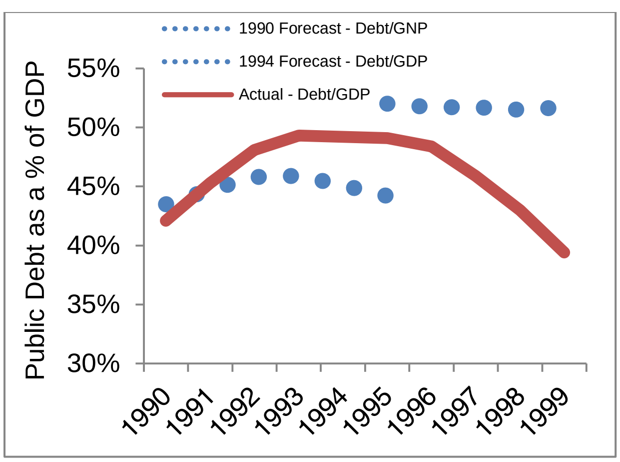
Source: BEA, accessed July 2013. BLS, accessed July 2013, CBO Staff Memorandum, "Budget Projections through 2001," October 1991, CBO Report, "CBO's Economic Forecasting Record," November 2002

Figure 4: Unemployment: Projected vs. Actual



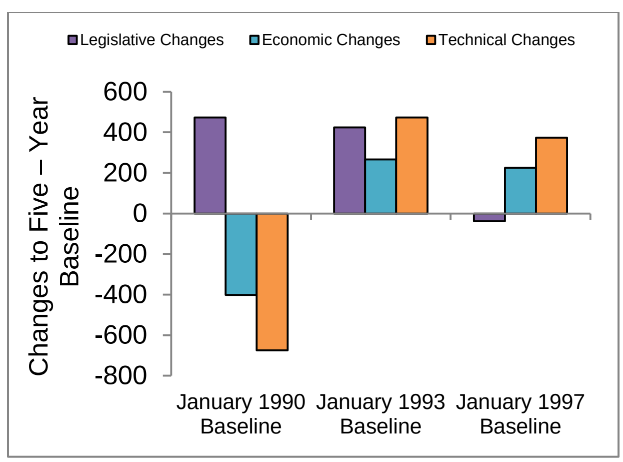
Source: BEA, accessed July 2013. BLS, accessed July 2013, Staff Memorandum, "Budget Projections Through 2001," October 1991, CBO Report, "CBO's Economic Forecasting Record," November 2002

Figure 5: Public Debt/GDP in Game 1



Source: CBO "Budget and Economic Outlook," 1990, 1994, 2013. Note: Until the late 1990s, CBO performed 5 year budget baseline projections, as opposed to the 10 year performed today.

Figure 6: Changes in CBO 5 Year Baselines



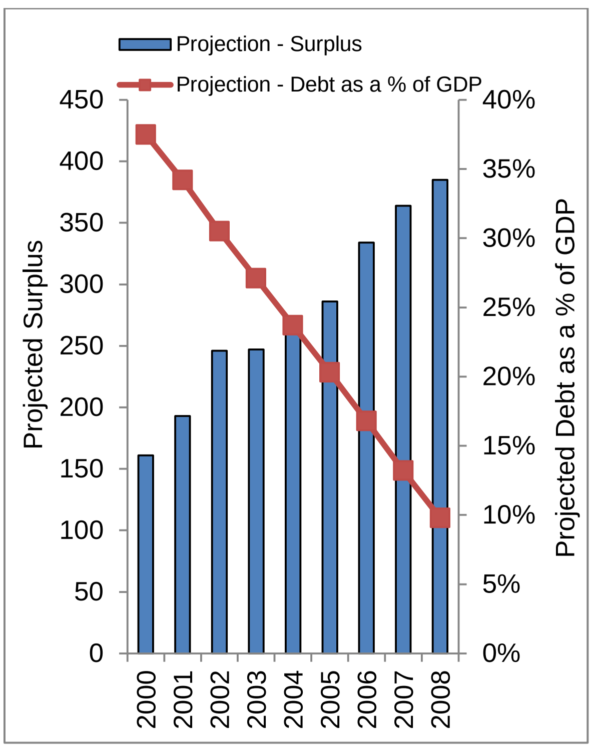
Source: CBO, January 2000. Note: Until the late 1990s, CBO performed 5 year budget baseline projections, as opposed to the 10 year performed today.

Game 2: FY2000-2008

Encouraged by their win, the Progress Promoters appeared ready to tackle Game 2 with the same fervor. Since the Progress Promoters achieved the goal of a budget surplus, the objective changed, and to win the future *the Progress Promoters would have to begin tackling our long range structural deficits – driven by known demographic trends, rising health care costs and an outdated tax system.*

Momentum was in their favor. The nation's fiscal and economic picture was positive for the foreseeable future, as evidenced by Figure 7.

Figure 7: Federal Budget Projections (As of July 1999)



Source: CBO, July 1999, "Budget and Economic Outlook: An Update"

According to CBO, the total surplus between 2000 and 2008 was projected to be $2.5 trillion. Public debt as a percent of GDP was expected to plummet from 44 percent in 1998 to 6.4 percent in 2009. GDP growth was anticipated to hold steady at around 2.4 percent, and the unemployment rate was expected to fall and remain at 2.5 percent.[5] Would the Progress Promoters seize the opportunity and close out the series?

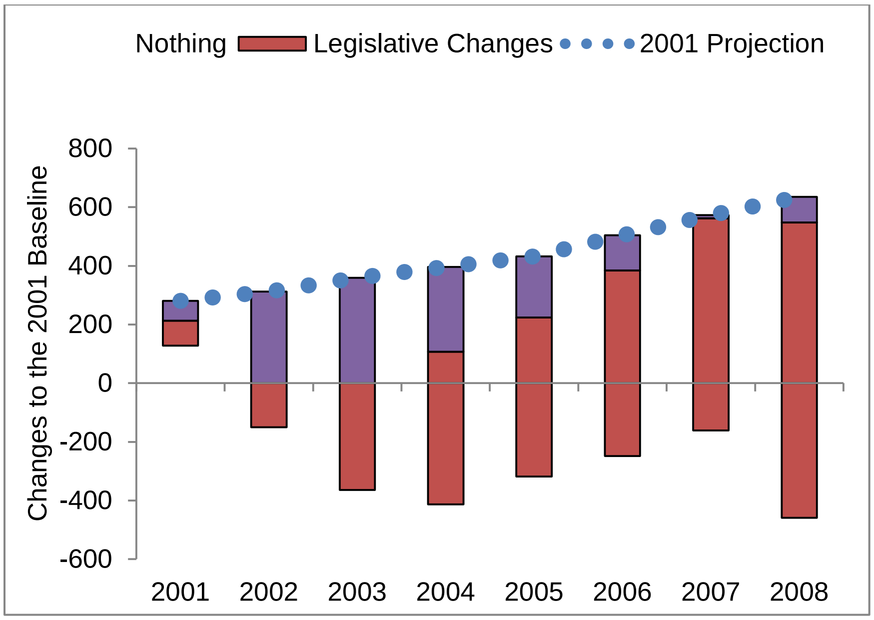
Unfortunately, the Progress Promoters were soundly defeated in Game 2. Multiple, unforeseen obstacles came to fruition, which deteriorated the nation's economic and fiscal picture (See Table 2 on page 11) Additional self-inflicted errors hurt as well, particularly in 2003—arguably the most fiscally irresponsible year in the history of our nation. During that year, Congress and the President passed additional tax cuts despite the fact that deficits had returned, enacted additional and largely unfunded Medicare entitlements, and began a new, yet undeclared war that was charged to the nation's credit card. As shown in Figure 8, such legislative changes over the time period contributed greatly to the change from surplus to deficits over the time period.

Furthermore, while public debt as a percent of GDP rose a modest 0.9 percentage point during this time period,[ii] it had been projected to decline significantly at the start of the time period, as shown in Figure 9. It was also projected to rise substantially in coming decades given demographic trends and rising health care costs. Even before the full onset of the "Great Recession," which had yet to occur, large deficits were projected well into the future, and the federal government's total liabilities and unfunded promises had almost tripled to $56.4 trillion in 2008.[6]

[ii] From the end of Fiscal Year 1990 to the end of Fiscal Year 1999

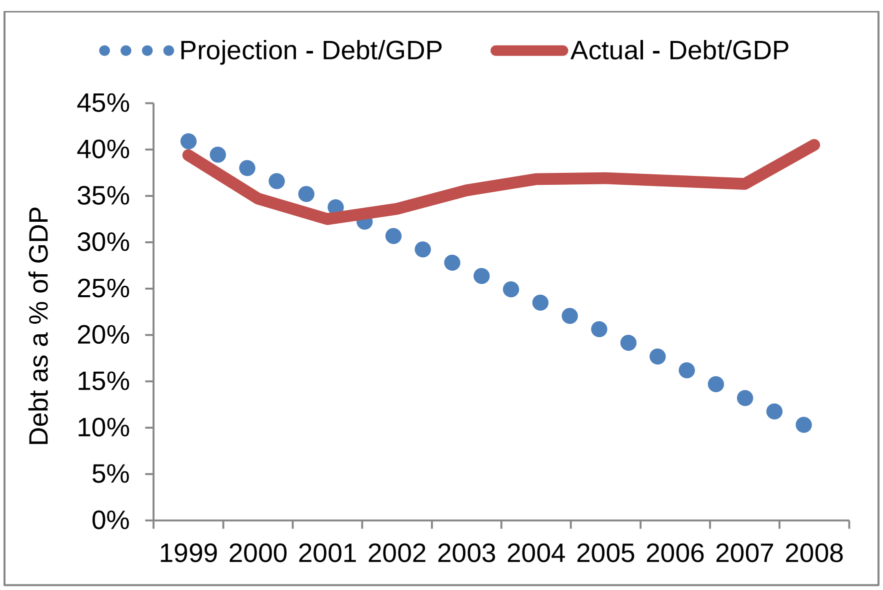
Unfortunately, due to the tragic events of September 11, 2001 and the subsequent government response, a lack of leadership by President George W. Bush, and poor support from the Congress, the opportunity to win was squandered. The projected surpluses at the start of Game 2 were long gone. Even worse, this failure preceded bursting of the housing bubble and the subsequent economic decline. Therefore, the momentum going into the third and deciding game shifted and was clearly in favor of the Debt Deniers.

Figure 8: Change in CBO Budget Projections FY2001-2008



Source: CBO, “Changes in CBO’s Baseline Projections Since January 2001,” June 2012

Figure 9: Public Debt as a % of GDP FY2000-2008



Source: CBO, “Budget and Economic Outlook: An Update,” July 1999 and “Budget and Economic Outlook: An Update,” May 2013

Table 1: Major Plays in Game 1 (FY 1991-1999)

Budget Enforcement Act of 1990 (BEA)	The BEA created new budget enforcement mechanisms that improved the Gramm-Rudman-Hollings Act, including the establishment of discretionary spending caps and “pay-as-you-go” (PAYGO) rules for both taxes and entitlement programs. It passed with bipartisan support.
1992 First GAO Long Range Forecast	In 1992, the GAO issued its first long range projection for the federal government’s finances, which starkly demonstrated where the nation was headed, based on current spending and tax policies.
1992 Presidential Campaign	The 1992 presidential campaign was significant because of the emergence of H. Ross Perot’s campaign, which focused on large deficits and the growing national debt. Perot’s campaign brought much greater attention to the issue and opened a national discussion of the threat of the nation’s current fiscal path.
Omnibus Budget Reconciliation Act of 1993 (OBRA)	OBRA was designed to reduce the deficit by a projected estimate of almost $500 billion over five years by increasing taxes on high earnings. It also extended the PAYGO rules from the BEA and the discretionary spending caps through 1998. OBRA passed on party line votes.
Kerrey-Danforth Entitlement Reform Commission	In 1993, the Kerrey-Danforth commission was established to examine Social Security, Medicare, welfare, tax breaks, and military retirement. The ideas did not have the 60 percent support needed to send its proposals to the White House. The Kerrey-Danforth commission did not gain consensus, nor did it release any recommendations.
Clinton Reinventing Government Initiative	Clinton established the National Partnership for Reinventing Government, which aimed to put customers first, cut red tape, empower employees to get results, and get back to basics.
1995-1996 Government Shutdown	The government suspended all non-essential services between November 14th and 19th 1995, and December 16th 1995 and January 6th 1996. The shutdown caused significant disruptions in government services and undercut public trust.
1997 Balanced Budget Act & Taxpayer Relief Act	The bills sought roughly $130 billion in deficit reduction over the next five years, and extended PAYGO and discretionary spending caps through fiscal year 2002. Both bills passed with overwhelming bipartisan support.
Breaux-Thomas Medicare Commission	In 1997, as part of the Balanced Budget Act, the National Bipartisan Commission on the Future of Medicare was created. It addressed the future of Medicare, given demographic strains. The proposal recommended a market-based premium support model, a higher eligibility age, a choice of plans, and a prescription drug benefit. However, it failed to get the required votes to be referred to Congress and the President.
1997 First CBO Long Range Forecast	The CBO performed its first long range budget forecast in 1997 because its previous ten year period projections did not show the impact of the major demographic changes that were on the horizon. It outlined the fiscal challenges associated with Medicare and Social Security and examined potential implications of reforms, but made no specific recommendations.
Clinton Social Security Initiative	In 1998, President Clinton supported a nationwide dialogue about Social Security through public forums. At the events, various non-partisan experts presented the facts about Social Security, and solicited input from the public about several reform options. Many people believe that if it wasn’t for the Monica Lewinsky scandal, the effort could have paved the way for comprehensive Social Security reform.
Economic Growth and Dotcom Bubble	The latter part of the decade saw an unanticipated economic boom. The strong economic growth was fueled in large part by the proliferation of the Internet, and the related tech bubble was fueled by the mystery and optimism associated with the Internet, an easy money policy, and heavy support from Wall Street.

Table 2: Major Plays in Game 2 (FY 2000-2008)

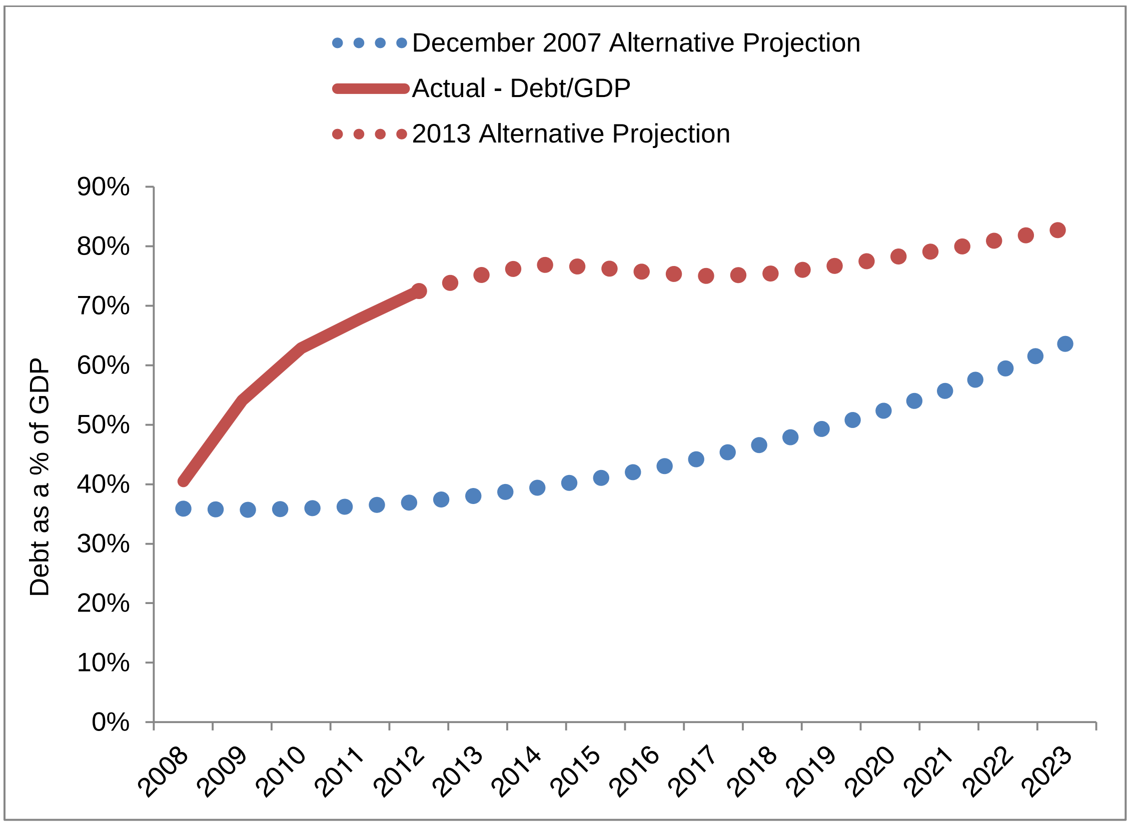
2000 Presidential Election	The 2000 presidential election was highly controversial and hotly contested, as Al Gore won the popular vote, but George W. Bush won in the Electoral College. This exacerbated an already partisan atmosphere, increased combat between the parties, and redistricting entrenched incumbents and expanded the ideological divide in D.C.
2001 Tax Cut	The Economic Growth and Tax Relief Reconciliation Act of 2001 lowered tax brackets, reduced the tax rate for capital gains, increased the exemption for the Alternative Minimum Tax, and made sweeping changes to the estate and gift taxes. It passed on party line votes.
September 11, 2001	Everyone remembers the terrorist attacks of September 11, 2001 and in their aftermath there was a brief period of bipartisanship in Congress. The nation came together and approval for the President and Congress soared to new heights. However, there was a significant and negative effect on the economy. Upon reopening, the Dow Jones dropped by 684 points, the largest single-day decline, and by the end of the week the index had fallen by 1,369 points.
2003 Tax Cut	The Jobs and Growth Tax Relief Reconciliation Act of 2003 was the second round of tax cuts in George W. Bush’s first term. The centerpiece of the bill was a reduction in the tax rate for capital gains and dividends. At the time of enactment, the CBO projected the 2003 tax cuts would add $349.7 billion to the deficit between 2003 and 2013. It was passed on a party line vote.
Afghanistan and Iraq Wars	In the wake of 9/11 the U.S. went to war with Afghanistan in 2001 and Iraq in 2003. Both conflicts were very costly. According to the CBO, the U.S. allocated $1.4 trillion for the wars in Afghanistan and Iraq between September 2001 and October 2012. Unlike previous wars, no special revenue source was enacted to pay for the wars and they were not formally declared by Congress, although both parties supported the actions.
Creation of Medicare Prescription Drug Benefit (Part D)	The Medicare Prescription Drug, Improvement and Modernization Act added a prescription drug benefit to Medicare, and in one year increased the Medicare unfunded obligation by $10.8 trillion, based on a 75-year projection. CBO estimated the bill would increase deficits by $394.3 billion between 2004 and 2013. It passed largely on party line votes.
Failed Social Security Push by Bush in 2005	President Bush pushed for major reforms to Social Security, but his proposal included private accounts, whereby workers would divert a third of their payroll taxes to a private account. This proposal faced sharp criticism, partly due to the negative impact on the deficit any such transition to private accounts would entail. He argued, unsuccessfully, that Social Security reform should focus on “opportunity” rather than “security.” No votes were taken in either chamber of Congress on the President’s proposal.
Onset of the “Great Recession”	Following the rescue of Bear Stearns in March 2008 and the failure of Lehman Brothers in September 2008, the world was plunged into the depths of the “Great Recession.” The crisis was fueled by irresponsible lending, a speculative housing bubble, and new financial instruments. The crisis devastated the economy, causing the government to take on significant private and corporate debts.

The Third & Deciding Game: FY2009-2017 and beyond

The severe loss in Game 2 and the onset of the "Great Recession" means achieving victory is going to be more difficult than ever. *To win requires a comprehensive approach - addressing short-term economic challenges, which at the start of Game 3 were arguably the worst since the Great Depression, while simultaneously beginning to address the even more serious structural deficit and debt challenges that lie ahead.* This all must be accomplished while getting debt as a percent of GDP down to a reasonable and sustainable level within a 10 to 15 year period of time.

Even before the recession's impact, public debt as a percent of GDP was projected to rise in the decades ahead, as shown in Figure 10.

Figure 10: Debt as a percent of GDP - Projected vs. Actual



Source: CBO, "Budget and Economic Outlook: An Update," May 2013 Alternative Scenario. 2007 Long Range Forecast.

The recession, and the government's response to it, expanded our public debt levels considerably. GDP contracted in the third quarter of 2008 and did not grow again until the first quarter of 2010. The recession demanded a quick counter-cyclical response, which resulted in even larger deficits. And while the U.S. has been growing, the CBO estimated that U.S. GDP growth would remain below its potential until 2017. By the end of fiscal year 2012, public debt as a percent of GDP had gone up about 33 percentage points from fiscal year 2008 to the end of fiscal year 2012. However, while the Progress Promoters fell behind early, they have started to rally.

Early Innings Recap (FY2009 to Present)

Over the past five years there have been numerous major events that have shaped the fiscal landscape; some positive and some negative. Table 3 illustrates the many events that have taken place, and the following paragraphs highlight some major events that have set the stage for where things stand in the final and deciding game.

Table 3: Major Plays in Game 3 (FY 2009-Present)

The American Recovery and Reinvestment Act of 2009	The bill included public works projects on infrastructure, social welfare provisions, short-term tax cuts, investments in education and renewable energy, and extended unemployment benefits. Independent and non-partisan observers acknowledge that the stimulus ensured that the recession was not deeper, created jobs, and sustained the social safety net. The bill was projected to add $787 billion to the deficit over 10 years.
Troubled Asset Relief Program (TARP) & Term Asset-Backed Securities Loan Facility (TALF)	The public sector bailed out the banks and a variety of other major financial institutions (e.g., AIG, Fannie Mae, Freddie Mac) either by directly purchasing toxic assets through TARP and/or through short-term loans through TALF.
Patient Protection and Affordable Care Act (ACA)	The bill passed in March 2010 on straight party line votes, and was designed to significantly reduce the number of uninsured, protect those with pre-existing conditions, and experiment with alternative health care payment models.
Simpson-Bowles Commission	In December 2010, the Simpson-Bowles Commission released its report that outlined a comprehensive framework to bring public debt as a percent of GDP to a reasonable and sustainable level over time. Unfortunately, the commission's proposal did not receive the requisite number of votes among commission members to be guaranteed a vote in Congress.
Domenici/Rivlin Commission	A report from the Debt Reduction Task Force, commissioned by the Bipartisan Policy Center, proposed many spending and tax reforms to bring our debt to a sustainable level over time.
The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act	Passed in December 2010, this bill extended the Bush Tax Cuts for most Americans and extended the unemployment and social welfare provisions in the stimulus package. The bill cost $858 billion over 10 years, relative to current law.
The Budget Control Act	This bill passed in August 2011 and temporarily solved the debt ceiling crisis. It increased the debt ceiling and is projected to achieve $917 billion in deficit reduction through placing caps on discretionary spending between 2012 and 2021.
Joint Committee on Deficit Reduction	This committee was created when the Budget Control Act was passed. It was designed to craft a bipartisan plan to reduce the short-term and structural deficits. On November 21, 2011 the super-committee announced it could not produce the necessary recommendations it had been tasked with formulating.
The Middle Class Tax Relief and Job Creation Act of 2012	In February 2012 this bill was passed to avert a payroll tax hike. It also included other provisions that added $89.3 billion to the deficit, over a ten year period, relative to current law.
2012 Presidential Campaign	The 2012 campaign halted any action in Congress to address our structural challenges. The presidential campaigns did not adequately address real substance in connection with fiscal solutions.
The "Fiscal Cliff" deal	This legislation included a small deficit reduction agreement that raised taxes on wealthier individuals and delayed automatic spending cuts until March 2013. The bill was projected to add $3.9 trillion to the deficit relative to current law, but save $0.6 trillion relative to the current policy of extending all the Bush and Obama era tax cuts.
2013 House and Senate budget resolutions	Congress and the President agreed on a plan to raise the debt ceiling if both chambers of congress agreed to pass budgets for the first time in four years. It avoided a showdown over the debt ceiling, but to date the House and the Senate have been unable to come to agreement on a joint budget resolution for fiscal year 2014.
The Sequester	In March 2013, automatic across-the-board spending cuts were enacted since Congress and the President failed to achieve additional progress to address the structural deficits that lie ahead. While the spending cuts will lower spending by $1.1 trillion over the next eight years, the CBO estimated that the cuts would reduce economic growth by 0.6 percent and prevent the creation or retention of about 750,000 jobs. However, CBO also said that repealing the sequester without fully offsetting the cost would result in more debt over a ten year period and slower economic growth than would be the case if it remained in place.

The “Great Recession” has had wide ranging economic, fiscal and societal implications, and it required extraordinary action by the federal government. Although the American Recovery and Reinvestment Act could have been better targeted and more effectively implemented in some areas, most independent and non-partisan observers acknowledge that the stimulus ensured that the recession was not deeper, created jobs, and sustained the social safety net.[7]

The stimulus plan contributed to the first of several trillion dollar annual deficits over the next few years. Undoubtedly, when President Obama entered the game he faced a very bad situation, and he took many steps to prevent a depression. These steps resulted in large deficits, which were to some extent understandable given the economic situation in early 2009.

After the initial response to the recession, attention in Washington turned toward health care reform, with the major event in 2010 being the passage of the Affordable Care Act (ACA). Given that U.S. health care spending is the highest per capita of the industrialized world, the priority given to health care reform was an understandable approach. However, the ACA made additional health care entitlement promises when, according to the 2009 Medicare Trustees Report, the federal government already had about $37.7 trillion in unfunded Medicare promises.[8]

When passed, the CBO estimated that the ACA would reduce the deficit over a 10-year period primarily through additional taxes and reductions in Medicare spending.[9] The bill also was designed to significantly reduce the number of uninsured, protect those with pre-existing conditions, and experiment with alternative health care payment models. However, CBO’s projections were based on a range of then current law assumptions. It noted such in its related cost estimates for the ACA, but these serious qualifications were largely ignored and absent from the public discourse in the lead up to the bill’s passage.

There continues to be a great deal of uncertainty regarding several aspects of the ACA, and whether many of the expected cost savings will come to fruition. Importantly, there are significant differences in cost projections between what the politicians claimed and what Medicare Trustees and the Office of the Chief Actuary of Medicare estimated. For example, in the first Medicare Trustees Report after the ACA was enacted into law, the Office of the Chief Actuary of Medicare estimated that the ACA could cost $10 trillion more than expected in discounted present value dollars calculated over a 75-year period.[10]

The National Commission on Fiscal Responsibility and Reform was issued in December 2010, commonly referred to as Simpson-Bowles, which outlined a comprehensive framework to bring public debt as a percent of GDP to a reasonable and sustainable level over time. Unfortunately, the commission’s proposal did not receive the requisite number of votes among commission members to be guaranteed a vote in Congress. Also issued in 2010 was a report from the Debt Reduction Task Force, commissioned by the Bipartisan Policy Center, commonly known as the Domenici/Rivlin Commission. It proposed many spending and tax reforms to bring our debt to a sustainable level over time.

2011 saw a lot of action on the fiscal front, with the most prominent event being the debate over raising the federal debt ceiling. With the U.S. set to default on its debt on August 3, 2011, there was heated controversy surrounding whether or not the debt ceiling should be raised. The Budget Control Act temporarily solved the debt ceiling drama, and was projected to achieve $917 billion in deficit reduction through placing caps on discretionary spending between 2012 and 2021.[11] Despite avoiding default, the drama caused S&P to downgrade the U.S. credit rating for the first time in history. Importantly, S&P noted that the dysfunction within the federal political system was a major factor in their decision to downgrade the federal debt.

The Budget Control Act created the Joint Committee on Deficit Reduction, which was designed to craft a bipartisan plan to achieve additional deficit reduction. On November 21, 2011 the so called "super-committee" announced it could not produce the necessary recommendations it had been tasked with formulating. Its super failure set the stage for other major events in future years.[III]

The most notable event in 2012 was the presidential campaign, as the campaign halted any action in Congress to address our structural challenges. In Washington, not much happens in election years unless a crisis forces action. Unfortunately, since federal elections happen every two years that drops the opportunity for progress by 50 percent!

The poor state of the economy was the focus of the presidential campaigns. Unfortunately neither candidate put forth a comprehensive, detailed, and realistic plan regarding how he would strengthen the economy, create jobs, and put our nation's finances in order.

After President Barack Obama's reelection, attention quickly shifted to avoiding the "fiscal cliff" - a combination of year end automatic tax increases and spending cuts, which, if left unaddressed, would harm the economy. Ultimately, a smaller deficit reduction agreement was reached that raised taxes on wealthier individuals and delayed automatic spending cuts until March 2013. The bill was projected to add $3.9 trillion to the deficit relative to current law, but save over $600 billion relative to the current policy of extending all the Bush and Obama era tax cuts.[12] This dual score keeping is just one example of why budget baselines are misleading, and confusing to the public.

In early 2013, Congress and the President agreed on a plan to raise the debt ceiling, coupled with a pledge that both chambers of Congress would pass budgets for the first time in four years. The House and Senate passed a budget after a watered down "No Budget, No Pay" bill, championed by the group No Labels, passed both chambers and was signed into law by President Obama. This was a positive development for the Progress Promoters because it avoided another showdown over the debt ceiling. Although both the House and Senate passed budget resolutions, to-date they have been unable to come to agreement on a joint budget resolution for Fiscal Year 2014, and are unlikely to do so.

[III]The Joint Committee on Deficit Reduction, otherwise known as the "Super-committee" was established by the Budget Control Act of 2011. The committee members were tasked with achieving an additional $1.2 trillion in deficit reduction. On November 21st the committee declared that bipartisan agreement "will not be possible." As part of the rules written into the Budget Control Act, because additional deficit reduction was not achieved, automatic cuts (the "sequester") were to take effect at the end of 2012. When combined with the automatic tax increases that were to occur at that same time period, it eventually set the stage for the so called fiscal cliff in December of 2012.

In March of 2013, as a result of Congress and the President failing to achieve additional progress to address the structural deficits that lie ahead, the implementation of blunt, across the board spending cuts known as the “sequester” took place. The sequester was designed to be so terrible that Congress would never allow it to happen. Unfortunately, this “tactical nuclear weapon” went off. While spending will be lowered by $1.1 trillion over the next eight years, the CBO estimated that in the absence of these cuts, economic growth would be about 0.6 percent faster, and the equivalent of about 750,000 more full time jobs would have been created or retained by the end of the calendar year.[13] This negative economic impact of the sequester is projected to continue next year. However, while the Congressional Budget Office has stated that repealing the sequester would improve economic performance in the short term, repealing it without offsetting savings would lead to additional federal debt, which eventually would reduce economic output over the longer term, below that which would occur if the sequester remained[14].

As it currently stands, a continuing resolution to fund the government for the early part of fiscal 2013-2014 appears likely. If this happens it will be the 58th time in the past 62 years that the Congress has failed to pass a budget and all appropriations (spending) bills by the beginning of the fiscal year. The threat of another debt ceiling fight also looms on the horizon.

Oddsmakers for Game 3: Will the Debt Deniers Prevail?

We are in the middle of Game 3, and while the prospects don’t look good at this time, the game is far from over and a win is still possible. It’s time for the Progress Promoters to get serious and put on their rally caps.

Losing the series would mean failing to effectively address our short-term economic challenge and our structural fiscal challenges in a comprehensive and integrated manner. Such a failure would result in higher than necessary unemployment, slower economic growth, and large and growing debt burdens. A loss could also have serious adverse effects on the U.S.’ position in the world, standard of living at home, and even the country’s national security and domestic tranquility over time. The game odds are impacted by three primary factors:

Growing Pessimism & “Fiscal Fatigue”

There is growing pessimism both in Washington and throughout the country regarding the ability to reach a grand bargain this year. In fact, most Americans don’t have much faith in Congress and its ability to pass any legislation. Additionally, the urgency to address our fiscal challenges this year has decreased, partly due to a false sense of security resulting from recent CBO projections showing a significantly lower deficit in fiscal year 2013 than in fiscal year 2012.[15] Shockingly, many people in Washington don’t seem to think that annual peacetime deficits of over $600 billion should be much of a concern! Many policymakers, pundits, and academics also continue to suffer from myopia (short sightedness) by ignoring the expected return to $1 trillion plus deficits just beyond the 10-year budget horizon.[16]

The lack of urgency also reflects a “fiscal fatigue” in Washington and among the public, as fierce political battles in recent years have damaged relationships within the Congress and between

Congress and the White House. The political rhetoric surrounding these fights has scarred both sides, and left elected officials wary of engaging in further battles given the potential mid-term election implications.

The fatigue is also driven by public opinion. The debt remains a difficult issue for the public to connect with personally. Poll numbers show that even though a large majority of Americans think the nation's mounting debt is a problem, they do not understand how it impacts the economy and their families.

A CBS poll in March of 2013 asked the following question, "What effect do you think reducing the federal budget deficit would have on the nation's economy?" Forty-two percent said it would make it better, 6 percent said worse, 9 percent said there would be no effect, 39 percent said they don't know enough, and 4 percent were unsure. Even though many polls are too simplistic and flawed, the fact that 58 percent of respondents don't understand the nature and significance of our fiscal challenge cannot be ignored.

In addition, most people, including members of Congress, do not realize that the Federal Reserve is essentially "self-dealing" in U.S. debt. The result is artificially low interest rates that result in short-term gain but increased risk of long-term pain. The U.S. faces serious interest rate risk when the economy fully recovers and the Federal Reserve discontinues its extraordinary purchases of U.S. debt, which is likely to start happening soon.[17]

Political Calendar

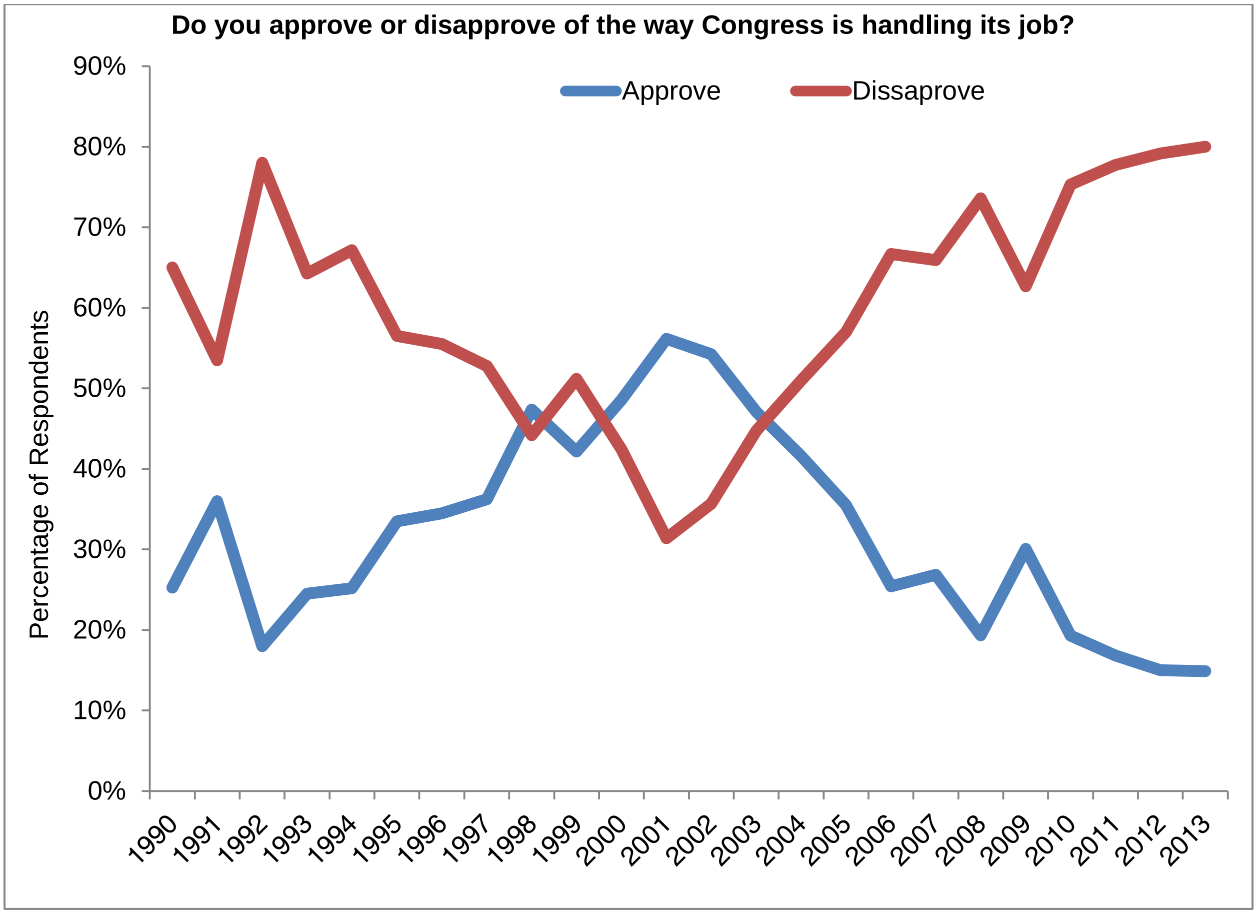
The increasing pessimism and fiscal fatigue is dangerous, given the fact that the budget deals to-date have generally only tackled the easy stuff—lowering caps on discretionary spending and raising taxes on the wealthy. The three key drivers of our structural deficits still remain – aging demographics, rising health care costs, and an outdated and inadequate tax system.

But if these issues are not addressed soon, the political calendar will take over. Focus will soon shift to the 2014 midterm elections, which will be quickly followed by the start of the 2016 presidential campaigns. A growing number of insiders in Washington, D.C. now feel that a real grand bargain may not happen until 2017, absent a market forcing event.

Broken Political System

Perhaps the most significant factor preventing progress is our dysfunctional democracy. Most Americans increasingly feel unfavorably towards Congress as an institution, as shown in Figure 11.

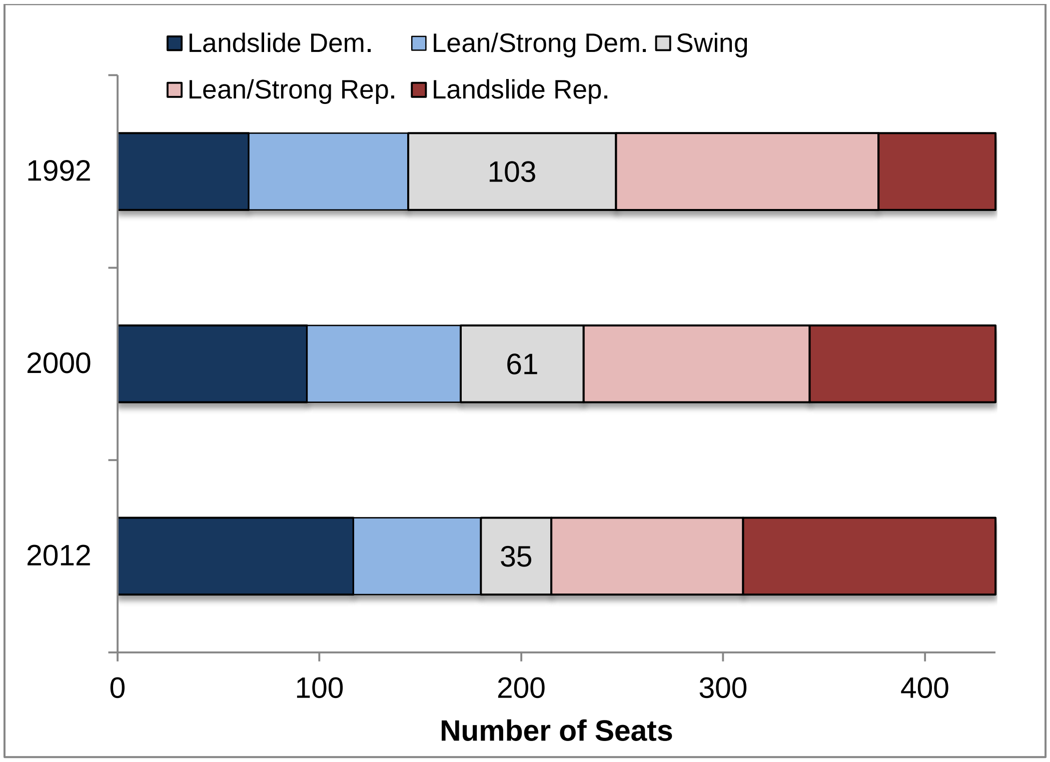
Figure 11: Public Approval of Congress



Source: Pew Research, “Congressional Favorability,” 2013

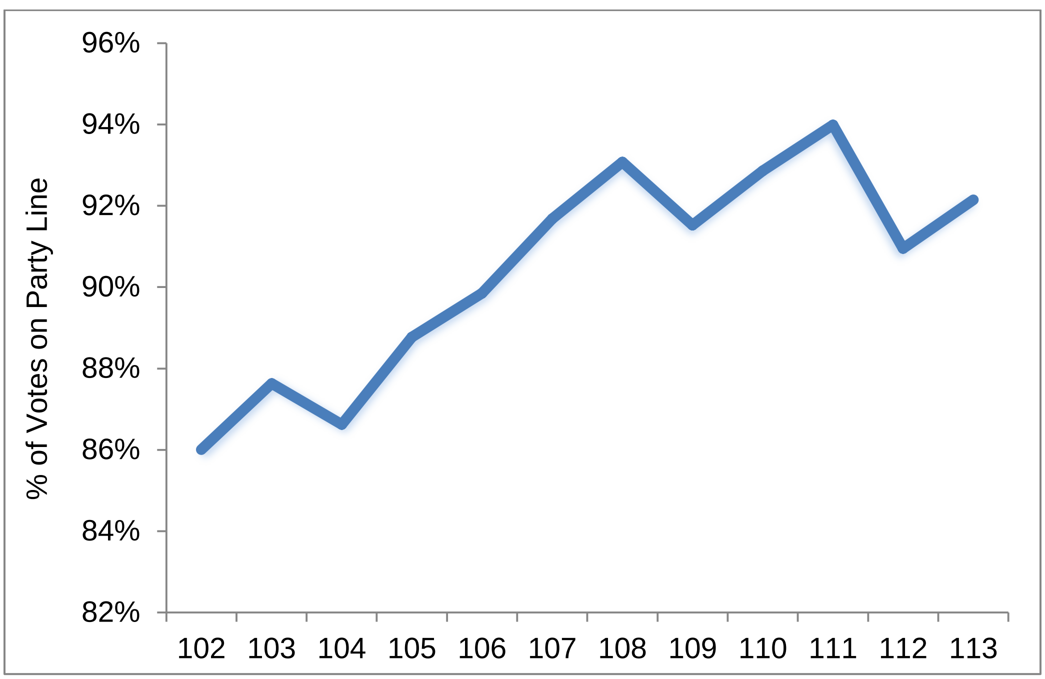
It seems that today the U.S. has become a republic that is no longer representative of or responsive to the general public. Polarization is one factor driving this trend, which is in part produced by a proliferation of uncompetitive districts caused by gerrymandering and closed partisan primaries, as illustrated in Figure 12. This has resulted in a great ideological divide within the Congress. It also increases party line votes as shown in Figure 13. Money and special interests play an increasing role in politics and both exert too much influence on elected officials. There has also been a growth in career politicians, which does not encourage innovation and transformation. All of these factors will need to be addressed in order to create an environment that will facilitate progress on the fiscal and other key sustainability challenges facing our nation.

Figure 12: Competitiveness of Congressional Districts



Source: Nate Silver, "As Swing Districts Dwindle, Can a Divided House Stand?" December 27, 2012

Figure 13: Party Line Votes in Congress



Source: Voteview, "Party Unity Scores," February 8, 2013

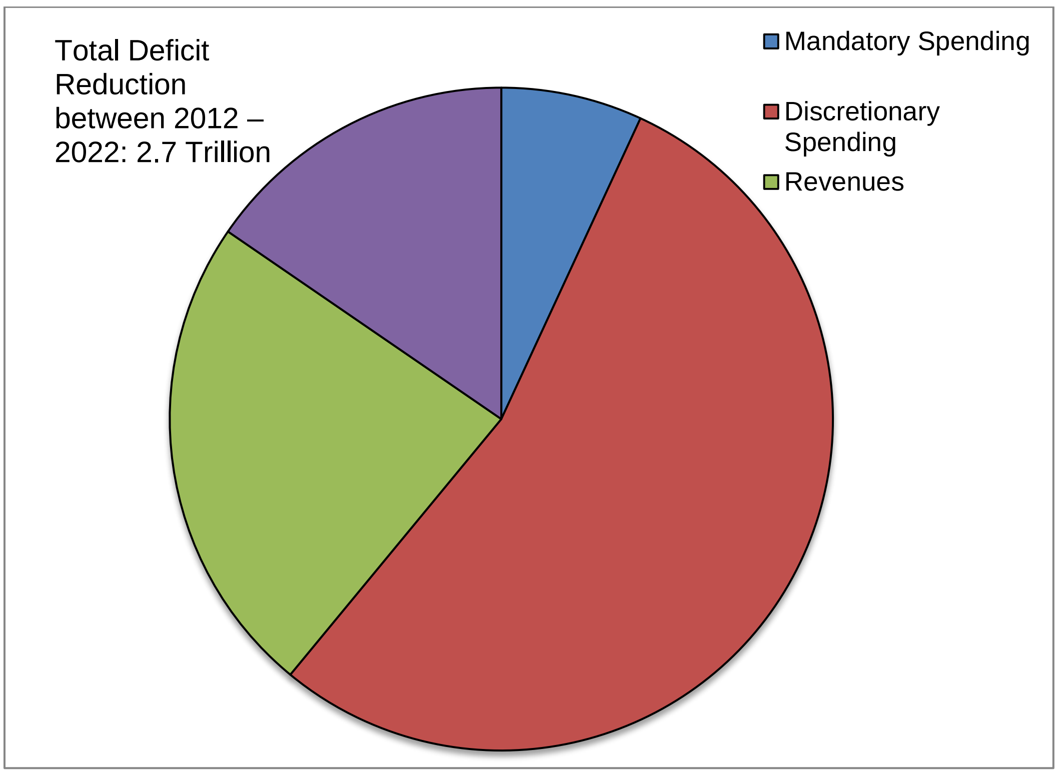
The Stakes: Why the Progress Promoters Must Rally & Win for America

The odds are currently against the Progress Promoters, but they cannot wait until later innings to begin staging a comeback. Many forces, intentionally or unintentionally, are aiding the Debt Deniers, but those supporting the Progress Promoters must rally for the following reasons:

It's Time to Treat the Disease Rather Than the Symptoms.

The fiscal deals and their impact over the past several years have failed to address the three core drivers of our structural imbalances. For example, Figure 14 shows the impact of the fiscal deals reached over the past several years. These include the continuing resolution passed in 2011, the Budget Control Act, the fiscal cliff deal, and the sequester. Combined, these deals have resulted in an estimated $2.7 trillion in deficit reduction over 10 years relative to current policy at the time of their enactment. However, these deals have generally just tackled the relatively "easy stuff."

Figure 14: Deficit Reduction from BCA, Sequester and Fiscal Cliff Deal



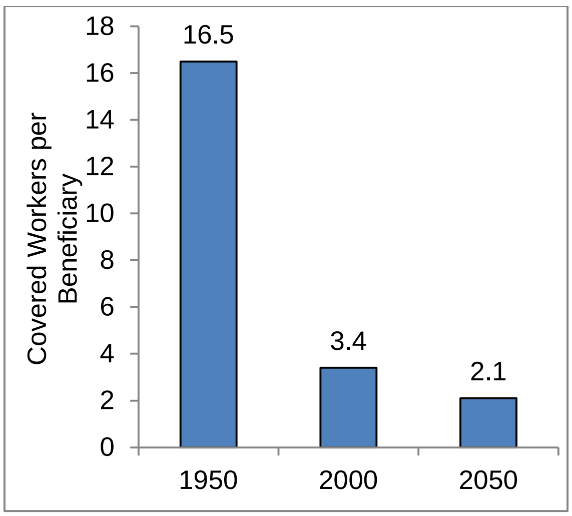
Source: CAI calculation based on CBO data.

While the impact of these deals shows a lower projected deficit and debt over the next ten years, debt levels are set to skyrocket again beyond the 10-year window, driven by these three key drivers.

None of the deals reached to date have accounted for the demographic tsunami that has begun with the retirement of the baby boomers. Over the next few decades, considerably more public resources will go towards supporting seniors, which means there will be relatively fewer resources available for investments and children.

In 1950, there were 16.5 workers for every retiree receiving benefits under Social Security. In 2000 there were 3.4, and by 2050 there will only be about two workers per retiree, as shown in Figure 15. As a result, the social insurance programs supporting seniors—Social Security, Medicare and Medicaid—will take up an ever increasing portion of the federal budget.

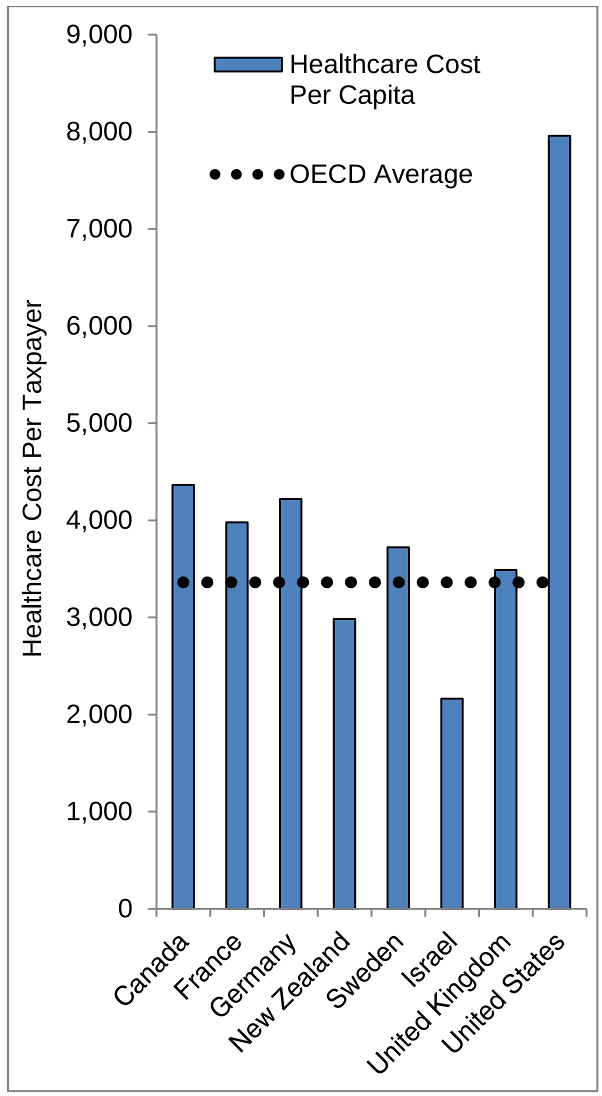
Figure 15: Covered Workers Per Beneficiary



Source: Social Security Trustees, "The 2013 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds," 2013

An aging society also means higher health care costs. If there is one thing that can bankrupt the nation, it is out of control health care costs. Society's aging contributes to it, but there are many other factors causing the U.S. to spend almost double per person on health care, compared to the average industrialized nation, as shown in Figure 16. Despite a recent slowdown in health care cost growth, many feel this slowdown is temporary and only time will tell. Health care costs consistently increase faster than inflation, but can vary depending on economic conditions and other factors. Regardless, aging demographics ensure that future costs will continue to rise for health care programs. Furthermore, given the uncertainty associated with the implementation and cost of the Affordable Care Act in the coming years, increased focus on health care policy is sorely needed.

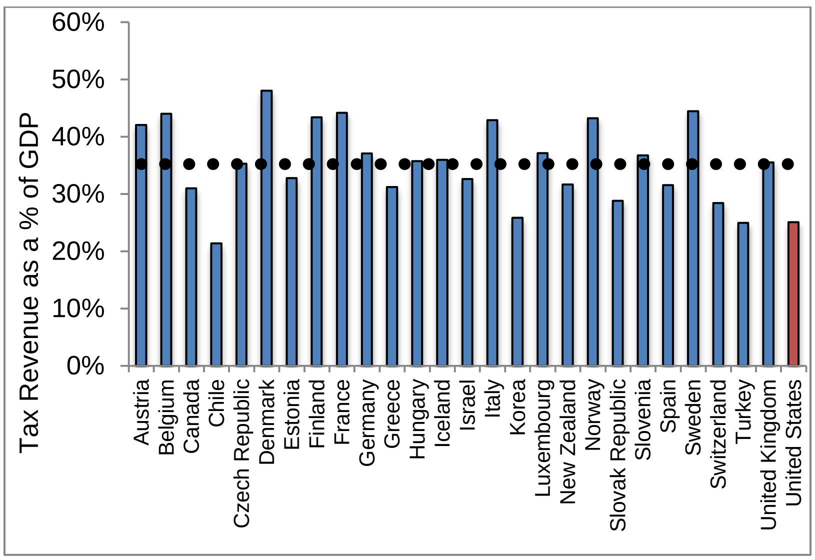
Figure 16: Health Care Costs Per Capita



Source: OECD

While demographics and health care costs are increasing spending, an inadequate and outdated tax system is harming U.S. competitiveness and not supplying sufficient revenues. Historically, U.S. federal, state and local governments have taken in combined revenues, on average, of about 26.5 percent of GDP, measured from 1965 to 2011. In 2011, the most recent year available, U.S. total government revenues were about 25.1 percent of GDP, which despite political rhetoric to the contrary, is considerably below the historical average of other major industrialized countries, which is about 35.2 percent, as shown in Figure 17. Total government revenues are projected to increase as a percent of GDP when the economy fully recovers, but will still be significantly below the average for other major industrialized nations. That does not, however, mean that the U.S. should seek to tax at the same level as these other countries. There are significant cultural differences and growth in the U.S. has generally exceeded the average for other industrialized nations.

Figure 17: Total Government Taxes as a % of GDP 2011



Source: OECD 2011

The tax code is loaded with dozens of deductions, credits, exclusions and exemptions (known as tax expenditures) that add to the code's complexity, reduce revenue, disproportionately benefit wealthier taxpayers, and in many cases don't work very effectively. It's time to call these tax expenditures what they are: back-door, open-ended and off-the-books spending programs. The foregone revenue from these tax expenditures is estimated to be more than $12 trillion between 2014 and 2023, according to CBO. These expenditures need to be subject to the same degree of scrutiny and re-examination as direct spending programs.

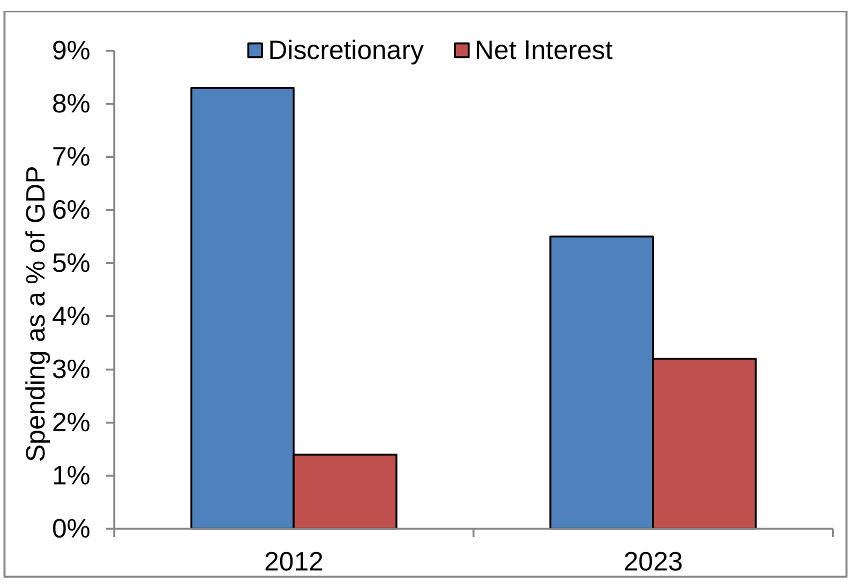
Help the Economy and Create More Opportunity For Both Today and Tomorrow

Addressing these three core drivers is not a long term issue; they must be addressed in order to improve the economy both in the short-term and for future generations. The economy has been slowly improving, but if a prudent fiscal grand bargain had already been enacted, rather than the fiscal bunts that have taken place so far, it would be doing much better than it is. The sequester is an example of a fiscal bunt that also represents poor fiscal policy, one that should be replaced with a more intelligent approach no later than when a grand bargain is reached. A grand bargain, coupled with timely and targeted investments to further stimulate the economy and create jobs, would set the federal government on a sustainable fiscal path and provide businesses with needed certainty, while also increasing consumer confidence. Agreeing on a framework for a grand bargain would also prove that Congress is capable of accomplishing something.

The forces supporting the Debt Deniers often pit the battle as those who support "austerity" against those who care about the economy and jobs. This is a false argument. The Progress Promoters want to do both. Namely, they want to address the short-term economic challenges and long-term structural challenges at the same time and in an integrated manner. They recognize that some well-designed and appropriately implemented investments in items like critical infrastructure and research and development might exacerbate the deficit in the short-term; however it can be acceptable if it is coupled with a clear, credible and enforceable plan to address the structural deficit and reduce public debt as a percent of GDP to a reasonable and sustainable level over time.

We also cannot delay action because while current interest rates are at historic lows, as the economy improves and the Federal Reserve winds down its program of investment in U.S. government debt, interest rates will rise. Already, interest is the fastest growing expense in the budget. And what do we get for interest? Nothing! Failing to address the three core drivers will result in growing interest costs that will crowd out other investments in the budget and the economy, which will decrease economic growth. CBO projects that by 2023, the U.S. will spend $823 billion on interest alone, which is more than the $724 billion we will spend on defense in that year.[18] This trend is shown by Figure 18, and the resulting squeeze in discretionary spending would be devastating and unsustainable.

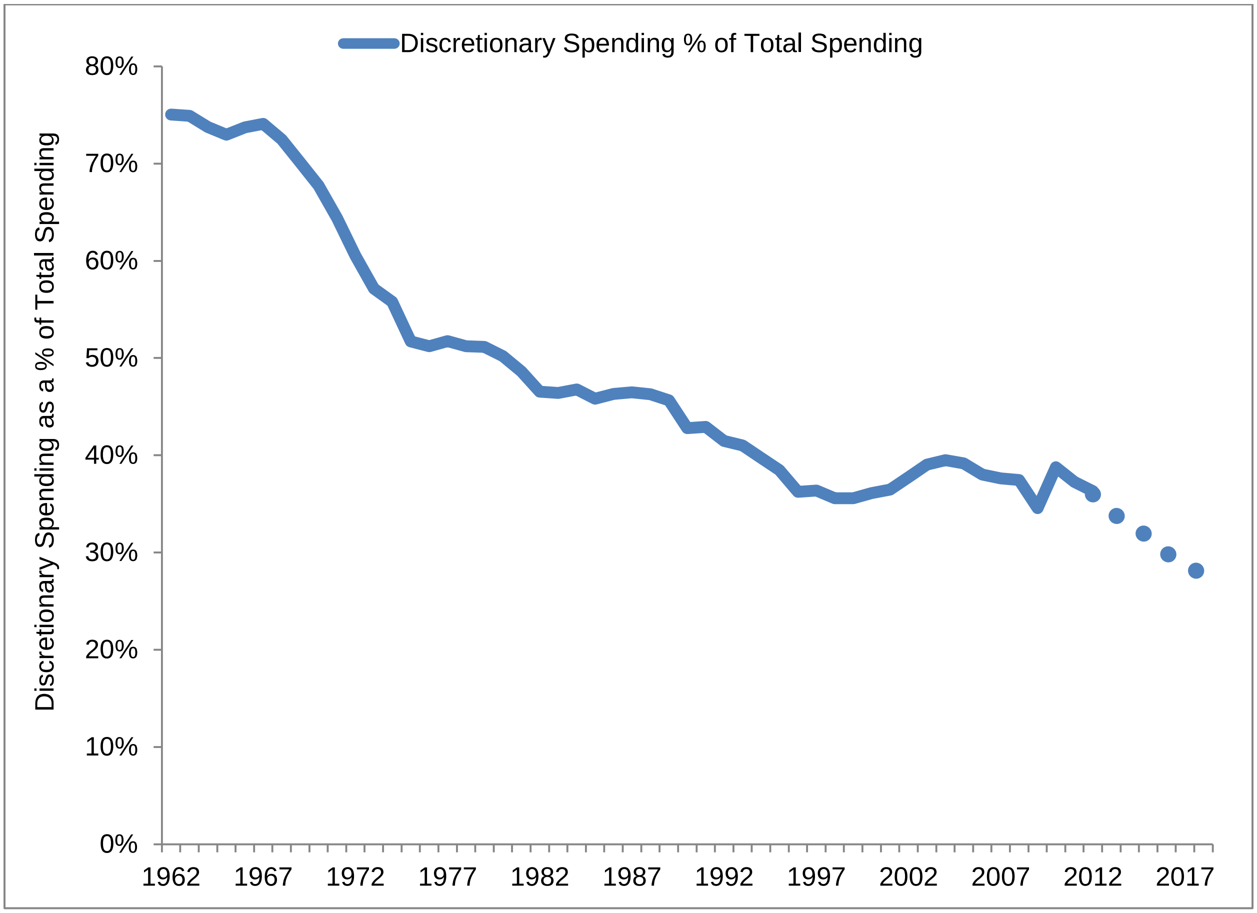
Figure 18: Interest vs. Discretionary Spending



Source: CBO, "Budget and Economic Outlook: An Update," May 2013

Even now, discretionary spending as a percentage of the federal budget has already been cut to historically low levels, and absent a change in course it will be squeezed even further, under an illogical, across-the-board, and one-size-fits-all approach. Figure 19 shows the historical trend of discretionary spending as a percentage of total spending.

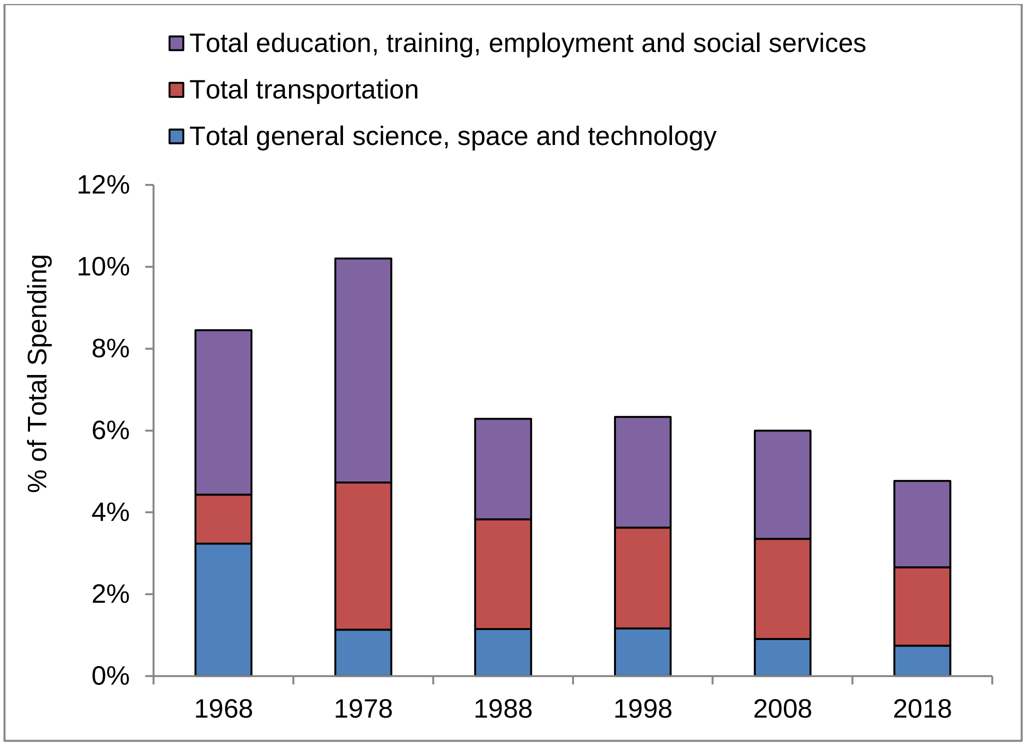
Figure 19: Discretionary Spending as a Percentage of Total Spending



Source: OMB, "White House 2014 Budget Historical Tables," April 2013

This matters because, as mentioned previously, discretionary spending includes all the express and enumerated responsibilities of the federal government under the Constitution. It also includes all investments in the future and all investments in young people, who represent our future. To illustrate, Figure 20 shows the historical and projected levels of spending on various investments in areas such as education, transportation, and science. Importantly, despite the lower funding allocated to these areas, one should not think spending programs within these areas are not in of review and reform.

Figure 20: Percent of Spending on Investments



Source: OMB, 2013

Acting Soon is the Smart Thing to Do

Acting prudently and preemptively is not something Washington is accustomed to doing, but it is the smart thing to do. The reforms necessary to address the three core drivers of our structural deficits will impact virtually all Americans to differing degrees. The right thing to do is decide on what changes to make and phase-in these changes over time, giving both people and businesses the time to adjust. The longer we wait, the less time we will have to introduce the needed changes, and the larger the changes will need to be.

Unfortunately, in recent years, Washington has lurched from budget crisis to budget crisis, (e.g., the debt ceiling, the fiscal cliff, the sequester) relying on these events to spur action, as opposed to acting prudently. But this isn't a recent phenomenon. While many cite the 1983 Social Security reform effort as an example of Washington acting in a preemptive and bipartisan fashion, this is misleading. In reality, Washington had to act because the so-called "trust fund" was going to run dry within months. If that happened, tens of millions of Americans would not have received their Social Security checks on time. This was clearly not acceptable, both from a political and economic perspective. In addition, while the combination of benefit changes and revenue increases restored program solvency for 75 years, the failure to address known demographic trends meant that it was guaranteed that additional Social Security reform would be required. As a result, the next reform effort should more adequately consider known demographic trends, and should be enacted much farther in advance of trust fund exhaustion, in order to avoid the accumulating cost of inaction.

The 2013 Social Security Trustees Report explains that by waiting to act, the size and scope of the changes to restore balance would rise, since the needed reforms would be borne by fewer generations and concentrated over fewer years. The Trustees estimate that if action to maintain Social Security solvency is deferred until the combined trust funds are exhausted in 2033, more drastic benefit cuts or tax increases would be required than if the same action was taken today. For example, Social Security is primarily funded by a 12.4 percent payroll tax up to a taxable wage-based cap, levied equally on employees and employers. Most economists acknowledge the employer portion is borne by employees in the form of reduced compensation. If action is deferred until 2033, it would require a 4.1 percentage point increase in the payroll tax, or an across-the-board 23 percent cut in benefits, to pay scheduled benefits in that year. Those amounts increase over time, and by the end of the 75-year actuarial period, in 2087, it would require a 17.5 percent payroll tax rate (a 5.1 percentage point increase compared to 12.4 percent today) or a benefit cut of 28 percent.[19]

By contrast, the Trustees estimate the 75-year actuarial deficit could be solved if the payroll tax were increased by 2.66 percentage points today and maintained. But increasing the payroll tax by that amount today would not be smart because it would be harmful to the economy and would be regressive. In addition, most reasoned policy analysts suggest a combination of benefit reforms and additional revenues to help ensure that the Social Security programs are solvent, sustainable and secure both today and indefinitely into the future.[20] The Trustees' example does, however, demonstrate that the problem grows with time, and that some combination of revenue increases and benefit adjustments should be phased-in as soon as possible in order for the power of compounding to start working in our favor rather than against us as it is today.

Furthermore, most proposals introduced regarding Social Security and Medicare typically shield certain individuals (e.g., those closest to retirement, the poor) from some of the needed changes. The longer the government waits, the more dramatic the changes will need to be, and the less freedom we will have to shield certain groups from the impact.

Finally, it is unlikely that Congress and the President will continue to keep discretionary spending at the low levels envisioned under the sequester. In addition, they need to put public debt as a percent of GDP on a declining path by the end of the decade in preparation for the demographic tsunami that lies ahead. Doing so would also provide enough fiscal flexibility to respond to unforeseen domestic or foreign challenges.

Doing the Right Thing for Future Generations

It is a long-standing ideal for each generation to leave the country better off and better positioned for future generations. It's called stewardship and that American ideal is now seriously threatened. Globalization and technology have resulted in a more competitive environment for younger generations, meaning their ability to achieve the American Dream is countered by numerous unprecedented challenges, exacerbated by large and growing societal gaps in education, income and wealth levels.

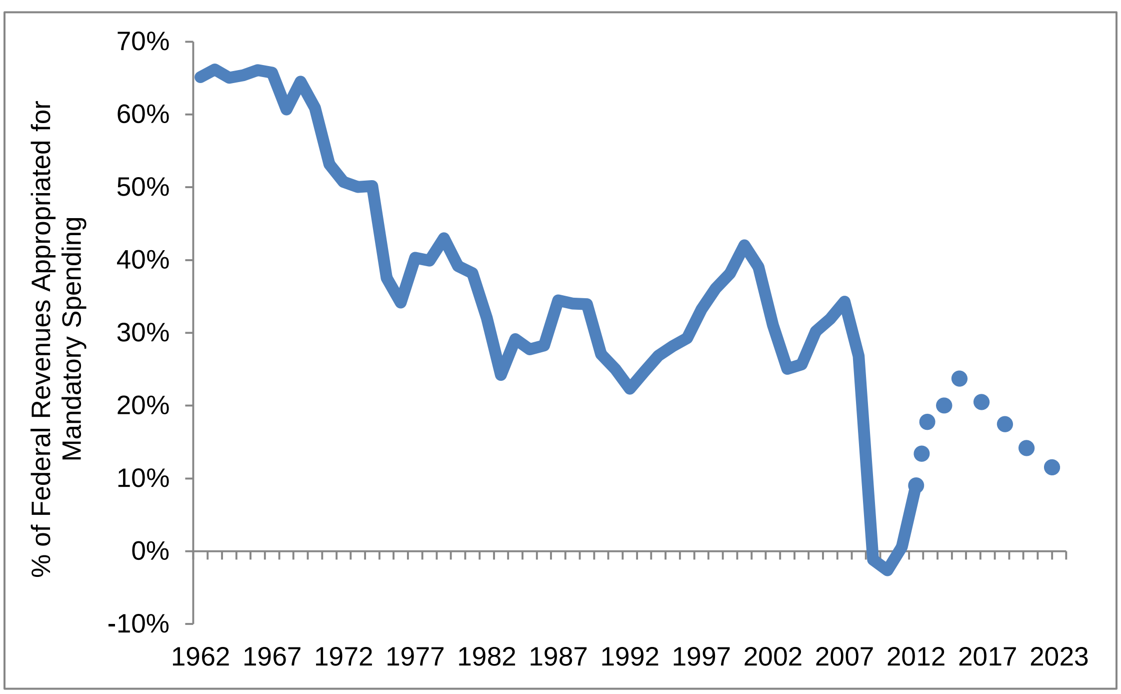
Let's call it as it is. Our current fiscal policy is mortgaging the future of today's young people and generations to come, while also reducing relative investments in their future. This is happening in a global environment that will mean more competition for young people in the years ahead. This approach is irresponsible, unethical, immoral and downright un-American. It must stop!

Failure to win the deciding game could seal the fate of younger generations. Eventually the three core drivers of our structural deficits must be addressed. The only question is whether the U.S. will act prudently and preemptively, or wait until economic conditions force us to act, possibly in a dramatic and draconian fashion.

Continuing to wait means passing the buck to those who did not cause this problem, but they will end up bearing the burden and paying the price. If action is not taken there will be lower government services, higher taxes, higher unemployment, and decreased government investment in their future.

In addition, the growth in mandatory spending means current and future generations will have less control over government priorities. Gene Steuerle, a senior fellow at The Urban Institute, created the Fiscal Democracy Index, displayed in Figure 21, which measures how much of each year's taxes and revenues have not already been allocated to mandatory spending and interest. In other words, it measures how much freedom the current generation has to choose its priorities, rather than being beholden to past commitments. In recent years the index has dipped below zero, meaning that the year began with more money committed to mandatory programs and interest than all taxes and revenue.

Figure 21: Fiscal Democracy Index



Source: CBO, "Budget and Economic Outlook: An Update," May 2013; Author's Calculations based on Fiscal Democracy Index developed by Eugene Steuerle of Urban Institute.

Game Plan for Victory

The stakes could not be higher, and the odds are not in the Progress Promoter's favor. Victory is attainable, but it will take patience, persistence, and perseverance to prevail. It also will require a good game plan.

Strategy 1 – A Realistic 2013 Objective

The Progress Promoters have to be realistic about what is achievable and when. The pessimism and fiscal fatigue is real, and therefore they must be smart about what can be accomplished this year and how.

Even if a grand bargain that solves all our structural challenges and sets debt on a sustainable path for decades to come is not reached this year, the Congress and the President can at least begin to lay the groundwork by first addressing the impending debt ceiling and appropriations process in a responsible fashion.

First, let's be clear on the elements of a real grand bargain. It should include some properly designed and appropriately implemented investments to get the economy moving and create more jobs. It also needs to address the sequester, which is both inappropriate in design and unsustainable over time. In doing so, the sequester should be replaced and supplemented with more targeted and intelligent discretionary spending actions combined with reforms to social insurance programs and other mandatory spending over time. These spending reductions should also be coupled with additional revenues achieved through comprehensive tax reform. In total, reductions in future spending should exceed additional revenues by at least 2-to-1, excluding interest. All of these actions should result in a declining ratio of public debt as a percent of the economy by the end of a decade, on a path to reach no more than 60 percent of GDP within a 15-year time period.

So what can get done this year? Realistically, a grand bargain should not be part of the approaching debt ceiling debate. The debt ceiling should not be used as a bargaining tool, but should be lifted through the 2014 election. The debt ceiling should eventually be replaced with statutory budget controls, and possibly a constitutional amendment establishing a public debt as a percent of GDP "credit card" limit.

It does, however, make sense to link a grand bargain framework to the negotiations over the next fiscal year's annual appropriations. In order for a framework to be successful, all parties involved must agree on a goal and specific targets, as well as a realistic timeframe in which a grand bargain can be finalized and implemented.

Ideally, three key steps should be taken during the appropriations process to pave the way for long-term growth and prosperity.

First, both parties should agree to replace part of the sequester with reductions in mandatory spending. In doing so, they should include both specific reforms, as well as targets for others, to be determined later. These mandatory reductions should include genuine reforms to Medicare, Medicaid and Social Security. In this regard, the responsible parties can look at bipartisan reform options that have been proposed in recent years. In addition, Social Security should be addressed as part of a broader retirement income security review. Importantly, whatever reductions are proposed to replace the sequester, they must be done in a clear, credible and enforceable way that ensures the same amount of savings would be achieved over a ten-year period and beyond.

Second, targets for further reductions in social insurance spending and other health care spending should be set, with relevant congressional committees charged with coming up with legislation that would achieve the targeted savings by a specified date. Third, Congress should set a target for additional revenue through tax reform, and assign relevant congressional committees to do so by a specified date.

Unfortunately, many believe that even agreeing on a framework for a grand bargain may be beyond the reach of Congress this calendar year. In which case, Congress should try to reach a shorter-term deal (e.g., 2 years) to replace the sequester with more intelligent and targeted mandatory and discretionary spending cuts coupled with targeted short-term investments and needed process reforms. If passed, process reforms could change how Congress passes future budgets and spending bills, while spending additional time on improving the economy, efficiency and effectiveness of the federal government. For example, biennial budgeting would require federal agencies to work on budgets much further in advance than they currently do. It would give Congress more time for oversight, which would hopefully lead to the revision or elimination of inefficient and ineffective programs. Reinstating more effective statutory PAYGO rules, meaning that any new spending or tax proposal must not add to the federal deficit, could also help. In addition, passing meaningful No Budget, No Pay legislation and creating a Government Transformation Commission,[21] with guaranteed hearings and vote on its recommendations, would help us address serious and long-standing operational problems in the federal government.

Strategy 2 – Change the Way We Keep Score

A challenge faced by the Progress Promoters over the years has been confusion over terminology related to the debt issue, and how best to show the full impact of the financial challenge the nation faces. In order to truly measure performance one must understand the nation's current fiscal situation, whether the future trajectory is getting better or worse, and how the nation compares to other major countries.

Too often, politicians, the media, and the public confuse deficits with debt. The two are related, but are very different concepts. Deficits are the annual amount by which spending exceeds revenue. Debt is the accumulation of past deficits. In Game 3, while the current deficits, including the trillion dollar ones over the past few years, are a problem, they are not the core problem.

The Progress Promoters must articulate clearly that the problem is not where we've been, nor where we are, but where we're headed: our mounting debt – more precisely, our debt relative to the size of our economy – is set to skyrocket, absent a change in course. Focusing on public debt as a percent of GDP as the metric of success needs to be a top priority.

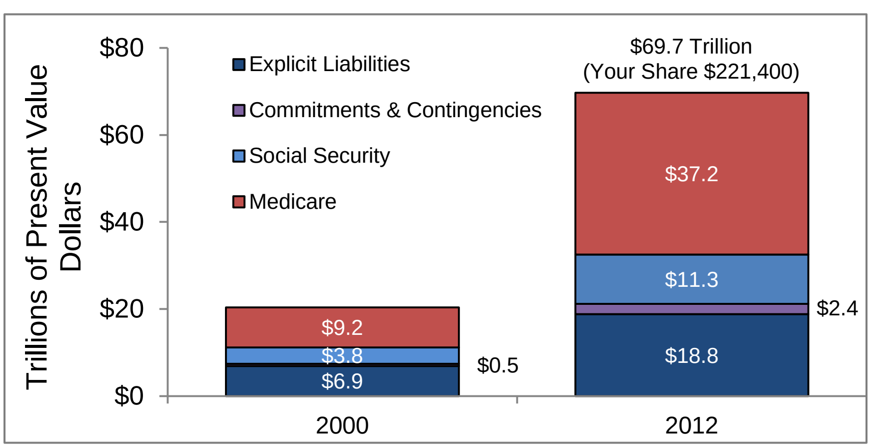
Importantly, public debt as a percent of GDP is better than other metrics often cited, including balancing the budget, because balanced budget requirements are rarely enforced, and, as we have seen at the state and local level, governments can employ accounting tricks to make a budget appear balanced even if in reality it is not.

As proven throughout history, some level of debt is okay. A problem arises when the level of debt is high in relation to the government's ability to finance that debt. Therefore, economists typically cite public debt as a percent of GDP as the key metric by which to determine the fiscal health of the nation. The Progress Promoters must focus like a laser on reducing public debt as a percent of GDP to a reasonable and sustainable level, which according to most economists is 60 percent.[22]

Even though current debt as a percent of GDP is high, the main problem is not where we are today, but our future trajectory. This is driven by large and mounting future off-balance sheet obligations, especially large unfunded promises for Social Security and Medicare. To highlight the true size of the problem, CAI developed the U.S. Financial Burden Barometer, which is a more comprehensive assessment of the true size of the federal government's financial hole because it adds the numbers for total liabilities, unfunded social insurance promises, and various commitments and contingencies found in the U.S. financial statements, and shows them in current dollars. In other words, the Burden Barometer measures how much you would have to set aside today, combined with future accumulating interest, to pay for future commitments and promises.

Importantly, unlike the National Debt Clock, if a grand bargain is achieved, the Burden Barometer, and its rate of increase, can be significantly reduced. This is because if prudent choices are made now, our future obligations can be reduced in a fair and equitable manner, where the power of compounding will start working for us, rather than against us, as it is now. Therefore, it's a comprehensive way to measure our nation's financial challenge and to reflect progress in a way that other metrics cannot show. Figure 22 shows the true measure of our nation's financial hole, and how it has changed over time.

Figure 22: True Measure of Nation's Financial Hole

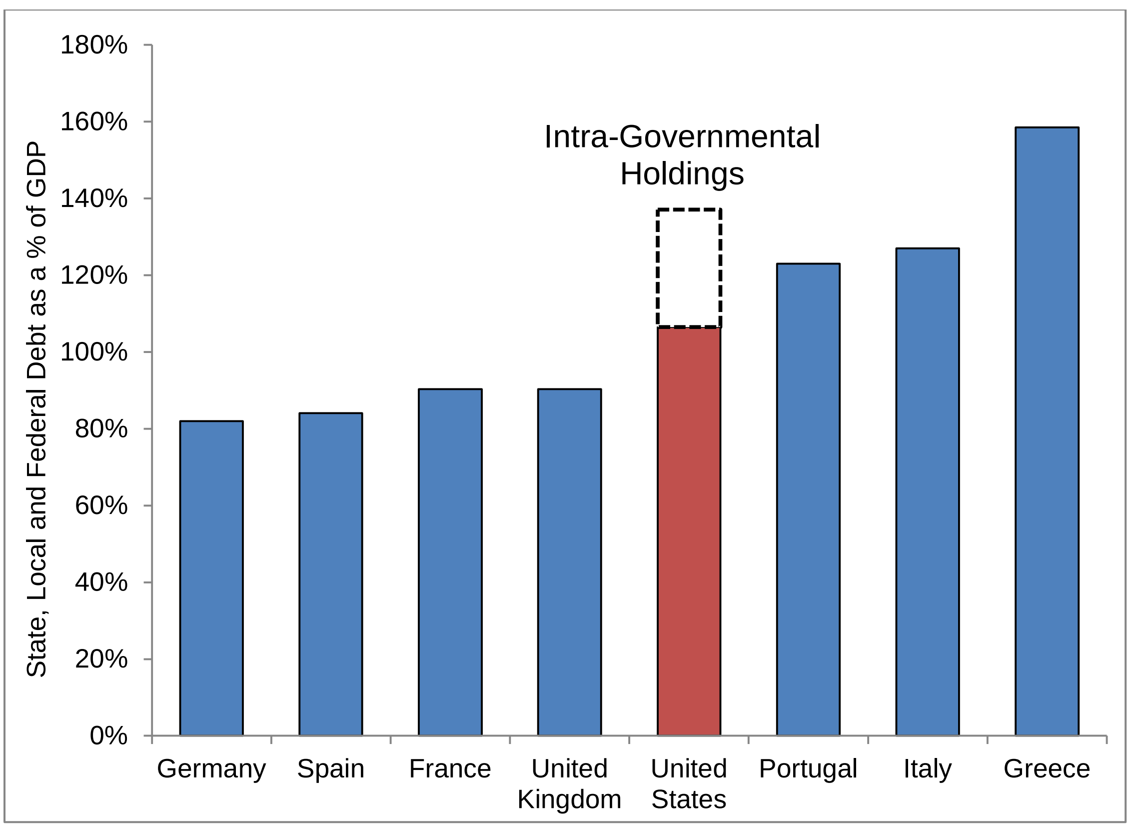


Source: Data from the Department of Treasury, 2012 Financial Report of the U.S. Government.
Note: Actuary's alternative estimates are used for 2012 Medicare projected benefits cost.

Given the competitive and globalized economy, understanding how the U.S. compares to others is also critically important. In 2011, CAI, in partnership with Stanford University, created the Sovereign Fiscal Responsibility Index (SFRI). The SFRI is a measurement of a country's fiscal health and sustainability. It used International Monetary Fund data to calculate a country's overall ranking based on its fiscal space, fiscal path, and fiscal governance. Fiscal space is the amount of additional debt, as a percent of GDP, a country could theoretically issue before a fiscal crisis is imminent. Fiscal path is a projection of a country's future level of debt, and fiscal governance is based on a country's fiscal rules, fiscal transparency, and fiscal enforceability. As of April 2012, the U.S. ranked 28th out of 34 countries, much closer to countries like Ireland and Greece that have suffered severe debt and fiscal crises. And while the U.S. is not Greece, in terms of its fiscal exposure, the U.S. is not exempt from the laws of prudent finance. While the U.S. has more time than Greece had to act, it does not have unlimited time, and it must ultimately act to put its fiscal house in order. By doing so, the Federal Reserve will also be able to return to a more prudent and sustainable monetary policy over time.

Importantly, to compare U.S. debt levels to other industrialized nations requires adding federal, state, and local debt and the amount of debt owed to Social Security and Medicare trust funds. On this basis, total U.S. debt as a percent of GDP was estimated to be 137.1 percent, as of 2012, higher than most other industrialized countries, as shown in Figure 23.

Figure 23: General Government Debt as a % of GDP 2012



Source: IMF, World Economic Outlook, April 2013; U.S. Treasury, Debt to the Penny.
Note: Additional data with dotted line represents intra-governmental holdings for the U.S. All figures for 2012.

We also need more transparency regarding the intergenerational implications of our current fiscal path. For example, the Intergenerational Financial Obligations Reform Act (INFORM Act) is a bill that has been introduced on Capitol Hill that would require CBO, GAO and OMB to incorporate "fiscal gap" and "generational accounting" analyses in their reports. This would also provide a better picture of the full size of our nation's long-term fiscal imbalances and highlight the intergenerational consequences of tax, spending and economic policy. Implementing these economic analyses would provide policymakers with better information about the true state of our nation's finances so they can make wiser decisions regarding the future.

Strategy 3 – Build Upon Successful Public Engagement

A comprehensive grand bargain will be difficult to achieve this year—if it is not, the Progress Promoters must not let pessimism and the election calendar year take over. Ultimately, politicians in Washington may fail to act until the price of doing nothing is greater than the political price of making tough choices. This requires large-scale public engagement, which Dave Walker, the Comeback America Initiative (CAI), and some other individuals and organizations have done over the past several years.

These public engagement activities have substantiated five core beliefs about the American people:

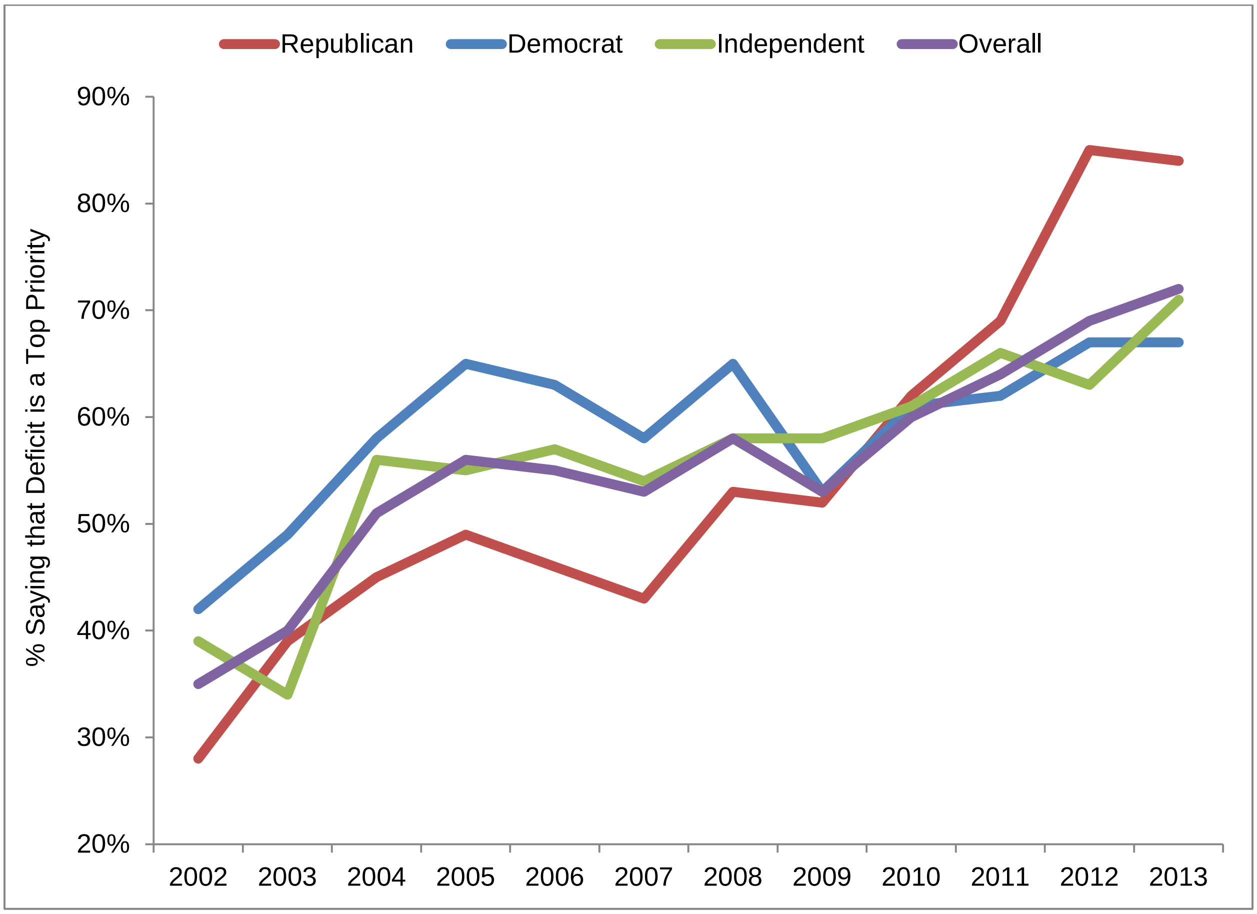
1. They are smarter than most politicians think;
2. They know we have a serious fiscal problem;
3. They are disgusted with the current state of political affairs in Washington, DC;
4. They can handle the truth about our nation's finances, and
5. They will accept tough choices regarding spending and taxes if they are part of a comprehensive fiscal reform plan they deem to be fair.

CAI has engaged the public in hundreds of events since its founding. During these events, CAI learned that most Americans believe that our nation's fiscal and debt challenges are serious and feel strongly that addressing our fiscal challenges should be a top priority for the nation. For example, at two town hall events held in the fall of 2012, in the battlefield states of Ohio and Virginia, with demographically representative groups of voters, CAI found some of the following results:

- 97 percent said that our nation's fiscal and debt challenges are serious
- 97 percent felt strongly that addressing our fiscal challenges should be a top priority for the nation
- 92 percent agreed with a set of six principles to guide a fiscal grand bargain
- 85 percent said that solving the nation's deficit and debt problems will require a combination of spending cuts and tax increases
- At least 77 percent support was achieved for specific packages of reforms in different areas, including budget controls, Social Security, health care, Medicare/Medicaid, defense, taxes, management reforms and political reforms. Budget control reforms received the maximum support of all packages (i.e., 90 percent).

We believe that these and other CAI related public engagement efforts, as well as those of many others who have dedicated themselves to raising awareness, have contributed greatly to increased public concern about our mounting debt challenges over the past several years. Evidence is clear that public awareness about our nation's debt challenges has increased dramatically over the past ten years. For example, the Pew Poll results in Figure 24 show the dramatic increase in people saying that the deficit is a top priority, across all political affiliations.

Figure 24: Percent Saying Deficit is a Top Priority



Source: Pew Research Center, "Twelve Years of the Public's Top Priorities," January 2013

There has also been increased media coverage of fiscal issues over the past 20 years. Research shows that articles mentioning "federal debt," "federal deficit," and "federal budget" in *The New York Times*, *USA Today*, and the *Washington Post* increased by just over 300 percent between 1993 and 2011, even after accounting for the proliferation of online publications.

This begs some questions – if the public is so concerned, why hasn't there been any action on these issues? Don't public opinion polls consistently show that the public is not willing to support specific types of reforms to social insurance programs or additional tax revenues? Isn't this inconsistent with the findings of CAI and others?

These are legitimate questions, but we believe this is a prime example of why it is important to learn from the successes of CAI and others, to learn from the past and employ new strategies.

For example, many public opinion polls are simplistic and misleading. Of course, when you ask someone in isolation, with no context, whether he or she supports a reform that will directly impact them, such as – "would you support raising the retirement age for Social Security or Medicare?" or "would you support raising taxes?" – you should not be surprised if they say no.

However, CAI proved that when you build a "burning platform" first – laying out the truth, the whole truth, and nothing but the truth regarding our nation's finances—the public is willing to accept tough choices if they are part of a package of reforms designed to achieve an important objective. Therefore, the challenge for the Progress Promoters is how to improve public engagement strategies to ensure more people are reached with the types of information that can make a difference.

It seems clear that public opinion can turn negative when people are asked about specific reform plans or proposals, especially if names of particular individuals or political parties are associated with them. This is partly attributable to the current political polarization in the U.S.

To counteract this, CAI has engaged the public on key principles for reform, which are easier to gain consensus on and serve as a basis for pulling people together rather than dividing them. Specifically, CAI has gauged the public on their support of the following six key principles for a fiscal grand bargain.

1. Pro-growth
2. Socially equitable
3. Culturally acceptable
4. Mathematically accurate
5. Politically feasible
6. Able to gain meaningful bipartisan support

Pro-growth means that reforms must boost economic output, thus increasing GDP, generating more jobs, and lowering public debt as a percent of GDP. Socially equitable reforms must be fair, not increase the poverty rate, and ensure that the country has a sound, secure and sustainable social safety net for those in need. Reforms must also be culturally acceptable, which means they would be supported by a majority of Americans, and attuned to the unique values and ideals of American society, including reasonable limits on the size of government and level of taxation. Importantly, the plan needs to have a specific goal, using reasonable assumptions where the numbers add up. Any reforms should be politically feasible, meaning they must pass both chambers of Congress with majority support in the House and generally achieve 60 votes in the Senate, and receive the signature of the President. Lastly, they must receive meaningful bipartisan support, with a substantial amount of the other party affirming, otherwise the results will not be sustainable over time, nor will they be deemed to be fair by the American people. CAI found that 92 percent of the representative groups of voters "believe the six principles for reform are a reasonable approach by which to measure any proposed fiscal reform."

In addition, instead of engaging citizens on specific reform plans, CAI has used sets of illustrative reforms, some developed on its own and others drawn from various bipartisan commissions (e.g., Simpson/Bowles, Domenici/Rivlin) or think tanks (e.g., Brookings, Heritage, Center for American Progress, American Enterprise Institute). For example, in July 2011, CAI released the “Restoring Fiscal Sanity” report, which outlined a preemptive and reactive framework of how to address our nation’s fiscal issues, and showed how various sets of illustrative reforms could bring our debt to a reasonable and sustainable level over time.

CAI has also used various online interactive approaches to educate and engage Americans about our fiscal challenges, and these efforts could be expanded upon. These include the Fiscal IQ Quiz, which is an online quiz where users can test their knowledge of and learn more about fiscal issues. The quiz has been taken by over 55,000 people in all 50 states and more than 100 countries.

In addition to leveraging these successful strategies, future citizen education and engagement activities must change the conversation in regards to fiscal issues and the debt. First, those advocating for fiscal reforms must build a burning platform so that the public understands action must be taken. In order to build a burning platform that will affect people, fiscal issues must be translated into terms that everyday Americans can relate to. Trillion dollar numbers must be translated into per person obligations and other terms that hit home with people. Why the mounting debt matters and how it impacts people personally must be made more explicit. Most people cannot comprehend how these large numbers at the federal level will personally affect their future job security, income levels, and purchasing power. They also don’t understand how it can impact our country’s position in the world and future actions.

Additionally, groups must do a better job explaining that the short term economic and structural fiscal challenges are both important, and that they should be addressed together in a comprehensive and integrated manner. A more diverse audience must also be reached, not just a greater number of people. Underrepresented groups, such as college students and younger workers, must be targeted and encouraged to get involved in this issue. Importantly, in order to give more credibility to public engagement efforts, town hall events should be scientifically representative, not self-selected samples, and to do so, more modern selection and interactive engagement approaches should be employed, such as those used by Stanford University’s Center for Deliberative Democracy.

Additional momentum is also needed at the grassroots level, in order to foster more incisiveness and accountability on many different fronts. Grassroots engagement will help encourage the public to push elected officials to act while holding them more accountable if they fail to do so. This would have the greatest impact on increasing the likelihood of achieving progress. Additionally, when it comes to politics, the media plays a large role in shaping perception. The public needs to hold the media accountable and ensure that it reports facts, and calls out politicians who make false or misleading statements. Beyond just holding the media accountable, the public should push for the media to move beyond parties and return to objective, impartial journalism. The media should pursue formats that focus more on the facts and help to explore potential solutions rather than engage in partisan conflict, ideological warfare and perpetuate the current stalemate.

Strategy 4 – Broaden the Message to Include State and Local Financial Challenges

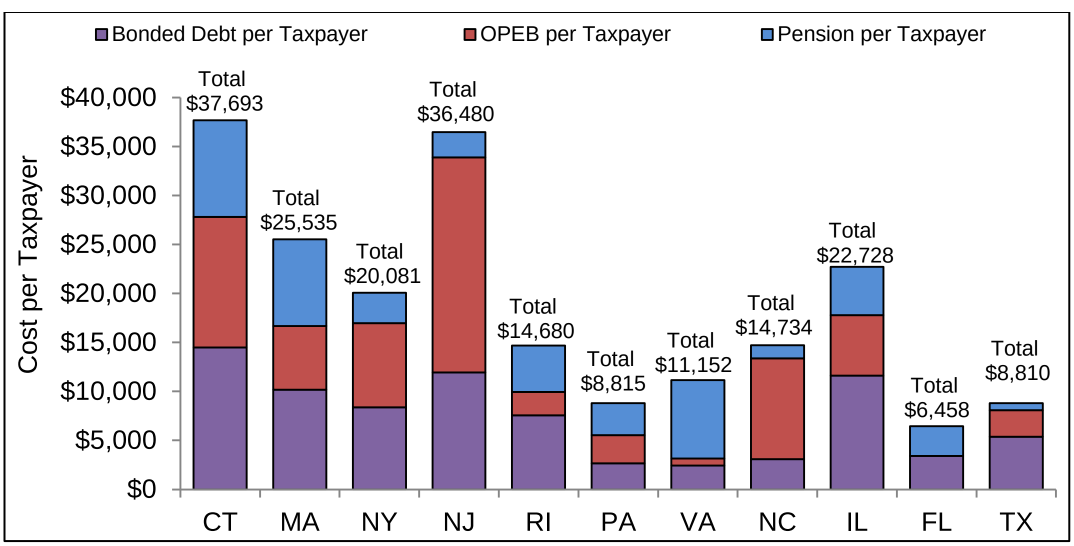
CAI has sought to highlight the fact that government at all levels faces similar structural challenges. For example, many governments have grown too big, promised too much, and need to restructure. Many state and local governments also face serious financial challenges, to differing degrees. In general, all levels of government face four common denominators:

1. Unfunded retiree benefits/promises (e.g. pensions and health care);
2. Rising health care and long-term care costs;
3. Outdated and inadequate tax and revenue systems, and
4. Too much spending on the past and not enough investment in the future.

The Progress Promoters would be wise to start integrating the impact that the federal fiscal challenge has on state and local governments into future communications messaging. After all, bad news flows downhill, and when the federal government inevitably restructures, states and localities will be adversely impacted. As a result, additional intergovernmental planning and execution activities will be needed in the future. Furthermore, the recent bankruptcy filing by the city of Detroit should serve as a wake-up call to many other municipalities that face similar financial challenges. The need to focus on the fiscal challenges facing states and localities could not be timelier.

In April 2013, CAI released a report titled “Connecticut at Risk: Will the State Navigate to Prosperity?” This report provided a comprehensive review of Connecticut’s fiscal and economic challenges, with the intention to spur conversations about how best to chart a course to future prosperity. For example, the report highlighted the growing unfunded pension and retiree health care obligations of state governments, as shown in Figure 25. While the report focuses on Connecticut, where CAI is based, it addresses issues that are relevant to a large number of other states, counties, and municipalities.

Figure 25: Total State Debt and Unfunded Liabilities Per Taxpayer



Source: Connecticut at Risk Report

Strategy 5 – New Fiscal Strategies Inside and Outside the Beltway

There are various strategies, some already ongoing, that should be built upon to achieve progress within the existing system, regardless of whether or not a grand bargain is achieved.

While several groups, including the Concord Coalition[23] and the Committee for a Responsible Federal Budget[24] and Fix the Debt[25], currently work inside and outside the Beltway by facilitating various public engagement activities, a more extensive grassroots effort outside the Beltway is still needed. The Concord Coalition has a grassroots network, but it's not large and geographically dispersed enough and one organization alone won't get the job done. The Institute for Truth In Accounting[26] is based in Chicago and focuses its efforts on the need for improved accounting, reporting, and budgeting practices at the state level. Other organizations focused at the federal level, such as Fix the Debt and The Can Kicks Back[27], have engaged new audiences, including CEOs and young people, respectively. However, a larger and more integrated grassroots network that can impact elected officials within their districts is still needed. This larger network needs to leverage social networking as well as increase the number of people who interact directly and in person with their elected representatives. It will take more boots on the ground and people in politicians' faces to accelerate action.

Another new strategy includes the Government Transformation Initiative (GTI),[28] a coalition of non-profits, corporations, academics and others that was recently formed to help transform how the government does business. GTI addresses organizational and operational concerns by focusing on issues like what the government does, how it does it, and how it measures success. GTI aims to establish a Government Transformation Commission that would oversee and direct the transformation of the organization and operations of the federal government. The Commission would also help to address "high risk" areas, reduce duplication and wasteful redundancies, achieve fiscal sustainability, and enhance credibility with the American people. GTI focuses on improving government's economy, efficiency and effectiveness, which were not the issues addressed by other fiscal commissions.

From a broader perspective, No Labels[29] is another relatively new player on the scene, trying to improve how the federal government conducts business. No Labels is a movement that promotes progress over partisanship and results over rhetoric. It is also focused on how to improve problem solving within the current political system. The organization has hundreds of thousands of supporters across the country and has already recruited over 80 members of Congress to become "Problem Solvers." The Problem Solvers agree to meet regularly and build trust across the aisle. They work to identify areas they can agree on and support legislative proposals that can achieve meaningful bipartisan support. No Labels has several published action plans that are focused on breaking down the structural problems that push leaders apart: Make Congress Work, Make the Presidency Work, Make America Work, and their newest initiative, Make Government Work. The Make Government Work! initiative includes nine bipartisan legislative proposals designed to improve the budget and appropriations process, and increase the economy, efficiency and effectiveness of the federal government.

Strategy 6 – Address the Leadership Deficit

The biggest deficit that Washington suffers from is a leadership deficit. While Washington still has many well-intentioned elected officials, the proliferation of career politicians, excessive partisanship, the great ideological divide, and the politics-is-war mentality has corrupted the system and generated gridlock. The public is urging individuals to step out from the crowd, to stand up and lead. When our nation has faced grave challenges in the past, leaders have stepped to the forefront and filled our history books. It's time for the President and the bipartisan leaders of Congress to step up to the plate in this fiscal fight for America's future.

The President, as CEO and Commander in Chief of our nation, is the only one who has both a unique opportunity and obligation to step up. Similar to a baseball pitcher's influence on a game's outcome, the President has a disproportionate impact on our nation's future course. Therefore, the President bears a greater obligation to lead. Only the President is truly elected by all the people. Only the President has the "bully pulpit" and the resources to lead a renewed public discussion.

The President's leadership role in regard to fiscal issues has been reflected over the past several decades, as highlighted by the results of the Fiscal Future Series to date. Presidents George H.W. Bush and Clinton made addressing our fiscal challenges a top priority and took politically difficult steps to do so. While President George W. Bush certainly faced unexpected challenges, there is no doubt that in regard to fiscal issues he pitched poorly.

As for President Obama, he undoubtedly inherited a tough fiscal and economic situation. He has made some efforts in the past to put the deciding game in hand, but has not succeeded to-date. He must get back in the game and bring his best stuff with him in order to help pitch us to victory. He must also be joined by bipartisan leaders in the Congress who want to solve problems and create a better future. We should not wait until the ninth inning to make tough choices and win the series.

The President must focus on bringing people together, rather than dividing people. He needs to act as the nation's CEO, rather than the head of one of two major political parties which are "at war." In that regard he can learn from President Clinton, President George H.W. Bush, and other past presidents about how to unite the public and illustrate what is needed to create a better future.

For example, compare the public engagement efforts of President Clinton versus President George W. Bush on Social Security reform. In 1998, President Clinton joined with bipartisan congressional leaders to hold several town hall events. During the events, professionals presented the facts and outlined possible solutions, including Dave Walker, CAI's Founder and CEO. The politicians listened and learned what types of reforms the public would be willing to support. In contrast, in 2005, President George W. Bush went to the public with a specific reform agenda and tried to persuade the public to accept all of his proposals, rather than asking the public's opinion. In addition, his approach was both partisan and ideological. As a result, despite many public events, his proposed reforms had less public support after his efforts than when he started.

President Obama needs to engage the public on critical issues and listen to their voices. These forums should involve credible and non-ideological professionals. He should invite bipartisan congressional leaders to participate, and if they refuse, demand a reason publicly. If Congress wants to raise its embarrassingly low approval ratings, they'd be wise to accept.

Importantly, while the President's leadership is essential, Congress must lead as well. Congress' failed leadership in connection with these issues has also impeded progress. Both parties in Congress must be willing to take on their respective bases by making tough political choices that put the public ahead of their own party and personal reelection prospects. Furthermore, harmful tactics, such as threatening the full faith and credit of the U.S., must not be employed.

Strategy 7 – Fixing Our Dysfunctional Democracy

Working within the existing system will only accomplish so much. Given the state of political affairs in Washington, now is the time to have a serious conversation about how to fix our dysfunctional democracy. We need to make our republic more representative of and responsive to the public. The political system must be reformed in order to dramatically change the way Washington does business.

Addressing the extreme partisanship, polarization and influence of special interests and money will take a variety of reforms. Some could be done through federal legislation, others can be achieved at the state level, and still others would require a constitutional amendment. In fact, some of the reforms are things we cannot expect the system to impose upon itself, and thus we need a serious national effort calling for needed political reforms—perhaps even an Article V Convention to propose specific amendments to our Constitution.

The fact is our political system is broken and has reached a tipping point, and while there are many groups that focus on discrete aspects of political reform, there is a void in terms of organizations that are advocating for comprehensive and structural changes to our political system in order to address the needs, challenges, and opportunities of the 21st century. Political reforms are sorely needed, and soon.

Changing our political system would affect not only economic and fiscal issues, but a variety of issues and causes that people care about. Not only would it make a grand bargain more feasible, but it would also increase the chance of action on issues such as energy and climate change, education, transportation/infrastructure, health care, immigration and a host of other challenges. Washington has been paralyzed by petty politics and controlled by special interests and career politicians for far too long. The time for real change has come.

Final Pep Talk

The Progress Promoters might be behind in the deciding game, but they can come back. Progress must prevail and the team has all the capabilities to rally. It's time for additional coordination and integration among the key players on and off the field. Major fiscal and political reform players and organizations must combine their efforts with those of the media, leverage technology, and expand grassroots related activities in order to effectively educate, engage, and activate the public.

We should still strive to hit a grand slam—a grand bargain that addresses our short-term economic and structural fiscal challenges. But we also should not shy away from singles and doubles, smaller victories that set the table for future success, such as new process reforms and enhanced public engagement efforts.

By uniting forces there is a greater hope that we will successfully address not only our nation's fiscal challenges, but other pressing issues that are important to Americans of all ages. In the final analysis, it's up to us. "We the People" must do what is necessary to create a better future for America. Remember the Boston Red Sox, in 2004. If they can do it, the Progress Promoters can do it too!!

Appendix 1: Brief History of U.S. Fiscal Policy (FY1789-1990)

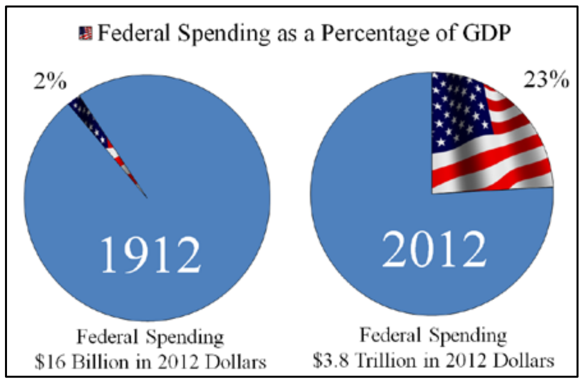
The need to act responsibly with regard to the federal government's finances dates back to our nation's founding as a republic and ratification of the U.S. Constitution in 1789. In his farewell address to the nation in 1796, President George Washington stressed the importance of fiscal responsibility:

> As a very important source of strength and security, cherish public credit. One method of preserving it is to use it as sparingly as possible, avoiding occasions of expense by cultivating peace, but remembering also that timely disbursements to prepare for danger frequently prevent much greater disbursements to repel it, avoiding the likewise accumulation of debt, not by shunning occasions of expense, by vigorous exertion in time of peace to discharge the debts which unavoidable wars have occasioned, **not ungenerously throwing upon posterity the burden which we ourselves ought to bear.**

Our elected leaders practiced fiscal responsibility for more than the first 100 years of our nation's existence. The years 1835 and 1836 are notable because, under the presidency of Andrew Jackson, the U.S. was debt free at the federal level. Even in times of war (e.g., the Civil War and the World Wars) there were large accumulations of debt, but the public debt as a percent of GDP burden was reduced after those wars ended. For the majority of our nation's history, deficits were short-lived because when necessary debt was incurred, spending was balanced with revenues, thereby helping to keep public debt as a percent of GDP at reasonable and sustainable levels.

In the early 20th century the federal government began to expand. Exactly 100 years ago this year, three important developments occurred—the creation of a federal income tax, the establishment of the U.S. Federal Reserve, and the adoption of the 17th amendment, which allowed for the direct election of U.S. Senators. These three events set the stage for a dramatic increase in the size and role of the federal government and a reduction in states' rights. The dramatic increase is illustrated in Figure 26, which shows federal spending as a percent of GDP.

Figure 26: Federal Government Spending (% GDP)



Source: Historical Statistics of the U.S., Millennial Edition Online, Cambridge 2006; CBO, Long-Term Budget Outlook, June 2012

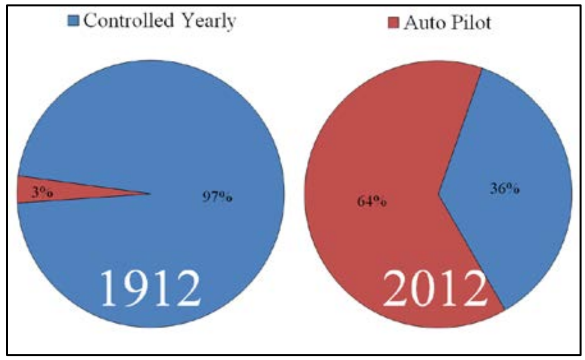
In 1912, before the three aforementioned events occurred, the size of the federal government as a share of the economy was only 2 percent. Last year, it rose to roughly 23 percent of the economy. This means that the federal government grew eleven and a half times bigger during that 100-year period.

Many factors contributed to the growth of government over the following decades. The Great Depression and New Deal drastically increased the size and scope of the federal government. The passage of the Social Security Act in 1935 marked the first major social insurance program promise by the federal government. During World War II there was an increase in spending and revenues, and public debt as a percent of the economy reached its highest point. It decreased thereafter due to a peacetime dividend, strong economic growth, and a return to fiscal prudence.

However, in the decades following the end of World War II, the landscape began to change with the addition of more 'mandatory' spending programs on social insurance, especially with the creation of Medicare and Medicaid in the 1960s and other Great Society anti-poverty programs. As a result, the federal government lost control of the budget. By 1962, discretionary spending declined to 68 percent of the budget, in comparison to 50 years earlier when discretionary spending was 97 percent of the budget.

In 2012, only 36 percent of spending was discretionary. Shockingly, discretionary spending includes all express and enumerated responsibilities of the federal government envisioned by the nation's founders and included in the Constitution, and all investments in the future. And the percentage of discretionary spending is set to decline to 24 percent of the federal budget by 2023 absent a change in our fiscal path. Figure 27 compares mandatory versus discretionary spending levels in 1912 to 2012.

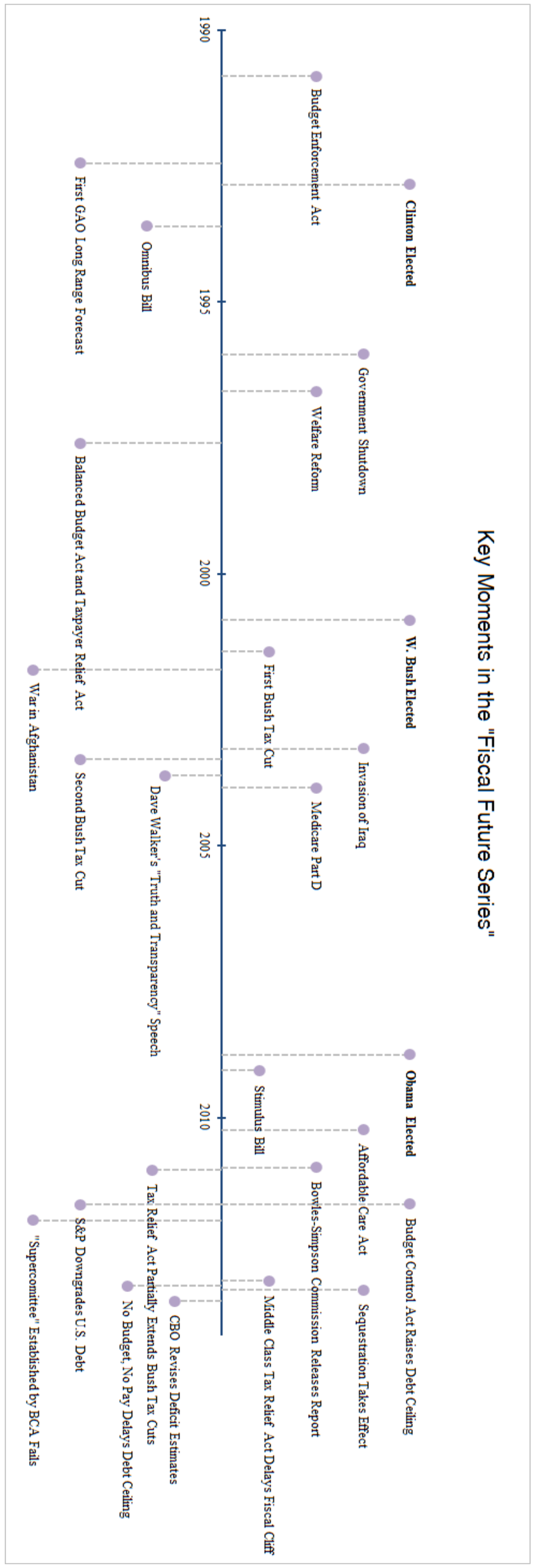
Figure 27: Mandatory vs. Discretionary Spending



Source: Historical Statistics of the U.S., Millennial Edition Online, Table Ea636-643 Federal government expenditure, by major function: 1789-1970. CBO, Historical Tables.

The expansion of mandatory spending programs, combined with a deteriorating economy, led to higher deficits during the 1970s, which were exacerbated during the 1980s when taxes were cut and national defense spending was increased, and offsets to other spending did not occur. Although the U.S. experienced strong economic growth during the 1980s, it was not enough, and large deficits and mounting debt burdens ensued. Congress recognized the problem, and attempted to address it through legislation establishing budget controls in the Gramm-Rudman-Hollings Acts of 1985 and 1987, but it was not enough. And so, the regular season ended, setting the stage for the Fiscal Future Series.

Appendix 2: Timeline of Key Moments in the "Fiscal Future Series"



Appendix 3: Advisory Council

Dr. Barry Anderson
Dr. Joseph R. Antos
J. Kyle Bass
Robert Bixby
Dr. Stuart Butler
Dr. Fred Carstensen
Jon Cowan
Manuel Espinoza
Mr. Roger W. Ferguson, Jr.
Dr. John C. Goodman
Peter Grandich
Dr. Alan Greenspan
Bob Greenstein (2010-2012)
Dr. Peter S. Heller
Marie N. Hollein
Dr. Douglas Holtz-Eakin
John Knubel
Michael Kong
Marilee P. Lau
Dr. Carolyn Lukensmeyer
John Mauldin
Maya MacGuineas
Dr. Donald B. Marron Jr.
Will Marshall
Dr. Joe Minarik
Alan A. Nadel
Bill Niskanen (deceased)
Dr. Paul L. Posner
Dr. Robert D. Reischauer
Dr. Alice Rivlin
Mr. Robert L. Rodriguez
Dr. Isabel V. Sawhill
Dr. Eugene C. Steuerle
Paul Volcker
Lisa S. Weatherby

Appendix 4: Board of Directors

J. Michael Cook (Chairman)
Hon. David M. Walker
Mr. Ernie Almonte
Mr. Norm Augustine
Mr. Mike Critelli
Ms. Carly Fiorina (2012-Present)
Hon. Harold Ford, Jr.
Hon. Mel Martinez (2010-2013)
Mr. William Novelli
Mr. Andy Stern (2010-2013)
Ms. Paula Van Ness
Mr. Jim Wallis (2010-2012)
Mr. Josh Weston

Others
Ms. Kathleen Benanti, Secretary
Mr. Paul Newman, Treasurer
Ms. Susan Tanaka, Observer

Appendix 5: Staff & Interns

Staff
Kathleen Benanti
Matthew Kahn (former)
Michael Murphy
Sarah Small (former)
Rachel Vierling

Former Interns
Ross Gionfriddo
Nina Satija
David Amar
Scott Greenberg
Ryan Siewert
Sean McElwee

[1] The Gramm-Rudman-Hollings Act of 1985
[2] Source: Congressional Budget Office, The Economic and Budget Outlook: Fiscal Years 1991-1995, January 1990
[3] Source: Congressional Budget Office, Budget and Economic Outlook: An Update, July 1999
[4] Source: The Budget Enforcement Act of 1990. Pub. Law No.:101-508
[5] Source: Congressional Budget Office, Budget and Economic Outlook, January 1999
[6] Source: 2008 Financial Report of the United States
[7] Source: Congressional Budget Office, Estimated Impact of the Stimulus Package on Employment and Economic Output, August 2010
[8] Source: 2009 United States Financial Report; Table 5 Present Values of Costs Less Revenue of 75-year Open Group Obligations HI, SMI, and OASDI. Pg. 157.
[9] Source: Congressional Budget Office; Cost Estimate Patient Protection and Affordable Care Act; 2010
[10] Source: $10 trillion dollars is the difference between the Medicare Trustees current law estimate vs. the illustrative scenario. The illustrative scenario includes many adjustments based on what may be unattainable assumptions built into the current law estimate with regards to the Affordable Care Act. These assumptions are explained in Medicare Office of the Actuary Memo dated August 5, 2010 entitled "Projected Medicare Expenditures under an Illustrative Scenario with Alternative Payment Updates to Medicare Providers.
[11] Source: Congressional Budget Office, Letter to Speaker Boehner and Majority Leader Reid on estimated impact of the Budget Control Act, August 1, 2011
[12] Source: Congressional Budget Office, The "Fiscal Cliff" Deal, January 4, 2013
[13] Congressional Budget Office, Automatic Reductions in Government Spending – aka Sequestration. February 28, 2013.
[14] Congressional Budget Office, Letter to Honorable Chris Van Hollen, "How Eliminating the Automatic Spending Reductions Specified in the Budget Control Act Would Affect the U.S. Economy in 2014. July 25, 2013.
[15] Source: Congressional Budget Office, Updated Budget Projections: Fiscal Years 2013 to 2023. May 14, 2013
[16] Ibid, Alternative Fiscal Scenario
[17] "Fed on Track to Ease up on Bond Buying Later This Year. Wall St. Journal. June 7, 2013.
[18] Source: Congressional Budget Office, Updated Budget Projections: Fiscal Years 2013 to 2023
[19] Source: 2013 Social Security Trustees Report, June 2013
[20] Source: See various bipartisan commissions and other proposals on Social Security reform, including CAI's Restoring Fiscal Sanity Report, the Simpson-Bowles Commission, the Bipartisan Policy Center's Debt Reduction Task Force, among others
[21] The Government Transformation Commission would be a statutory entity to aid in transforming and improving federal government processes and programs.
[22] The 60 percent of GDP target is most often cited by economists and other authoritative sources. For example, the International Monetary Fund. See "High Debt and Deficits Have Raised Risks, Says IMF." May 18, 2010.
[23] For more information about the Concord Coalition visit concordcoalition.org
[24] For more information about CRFB visit crfb.org
[25] For more information about Fix the Debt visit fixthedebt.org
[26] For more information about the Institute for Truth in Accounting visit truthinaccounting.org
[27] For more information about The Can Kicks Back visit thecankicksback.org
[28] For more information about the Government Transformation Initiative visit gticoalition.org
[29] For more information about No Labels visit nolabels.org

Thank You

I would like to thank the distinguished current and former members of CAI's Board of Directors and Advisory Council for their service, especially Mike Cook, Chairman of the Board. While CAI's life has been short, as CAI board member Norm Augustine said, "This small organization punches above its weight more than any organization I am aware of."

I would also like to thank our donors, especially the Peter G. Peterson Foundation, H. Ross Perot, Sr., and Robert Rodriguez.

I would like to thank our external contractors, especially OnPoint Strategies for their media and communications services.

Last, but not least, I would like to thank all of CAI's staff during the past three years, especially Kathleen Benanti, Mike Murphy, and Rachel Vierling, and intern Sean McElwee, who worked on this report.

By working together and with others, we proved that you don't have to be big to make a difference.

David M. Walker
Founder, CEO and Board Member
Bridgeport, CT