

Challenges facing the New President

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Thank you Jim (Steinberg) for that kind introduction. It's an honor to be a part of today's symposium with all of you. It was wonderful to have a chance to visit with Lucy and Linda, and it's great to be here at the LBJ Library and Museum - and at the LBJ School. As Jim noted, I have served on the advisory boards of two other undergraduate and graduate public policy programs and have taught at the John Glenn School of Public Affairs at The Ohio State University. So I have some perspective on public policy schools. I will tell you what you already know: The LBJ School is one of the finest in the country at preparing young leaders to take on the significant public policy challenges of our time. And in Jim Steinberg, you have an innovative leader who has made the school even more impressive.

To the students of the LBJ School of Public Affairs who are here today, I know all of you voted a month ago to the day (right?), and I hope you all experience public service in some capacity. Nothing is more rewarding than serving your fellow citizens - and working in government at some level is a fine way to serve. Plus, our country needs you.

We face many challenges both at home and abroad. As you have learned at the LBJ School, it will require leadership, innovative policy ideas, and bipartisan cooperation to solve them.

Today, I have been asked to talk about some of the domestic policy challenges that President-Elect Obama will face, and I will attempt to do that. But, consistent with the 100 year anniversary of his birth and the theme of other presenters here today, I will also touch on the LBJ legacy as it relates to some of these challenges. This will be intimidating given the number of true LBJ scholars, confidants and former colleagues, among us today.

So let's start with the challenges, and there will be plenty at President-Elect Obama's doorstep. In fact, though each of us has a list, I will give you my

top 10 – just on the domestic side (Jim can supply his top 10 on the foreign policy side)

Challenge number one: Jumpstarting the economy:

President-Elect Obama will come into office at a time when we are facing our most serious economic crisis since the Great Depression. As such, jobs and the economy will be his biggest immediate challenge and top priority, and I will talk about that in a moment.

But first, let me give you my list of the 9 additional priorities for the top 10. Because there are many, I will only discuss only a few in my remarks – but I hope this list will stimulate some interesting dialogue in the questions and answer period:

In addition to the immediate economic crisis – they are:

2. Reform of our important entitlement programs before they swallow the federal budget.
 3. Expanding access to insured health coverage and cost containment – both are critical.
 4. Ending our reliance on foreign oil in a way that addresses environmental challenges without ruining our manufacturing base.
 5. Preparing our workforce to meet the demands of the global economy.
 6. Facing up to our immigration problem.
 7. Building a new consensus on international trade so we can take advantage of the benefits of an increasing competitive and interdependent world, that won't stop for us.
 8. Smarter new federal regulations that catch up with the complexity of our economy and streamlining to provide regulatory accountability – especially in the financial sector – that preserves the free market advantages our economy has traditionally enjoyed.
- And finally,
9. Reform of the way the federal government operates - from ending earmarks to agency innovation.

OK, I know that's a lot – but it gives us a lot to talk about! Including how your top 10 will differ – Let's start with the immediate challenge of a faltering economy, rising unemployment, and as we've seen again this week, a volatile stock market.

Economists now tell us, based on the traditional criteria, that we have been

in a recession, albeit a mild one, for a year - - already longer than the average recession in modern times. Although we must be careful not to overreact to the immediate economic crisis and only deepen the longer-term challenges Washington has been incapable of addressing, I do think the economic challenge is job one.

Congress and the Bush Administration have already taken unprecedented efforts to stabilize markets and restore liquidity by authorizing the spending of \$700 billion in the Troubled Assets Relief Program, better known as TARP. But the scope of this goes well beyond the TARP. Other rescues have also been undertaken for AIG, Fannie Mae and Freddie Mac, Bear Stearns, and the Fed has issued unprecedented guarantees. As I add it all up, we have now made federal commitments of a jaw dropping \$4.2 trillion dollars or more over time.

With regard to TARP, based on Secretary Paulson's comments, it now looks as though President-Elect Obama's Administration will have about half - or \$350 billion of the initial \$700 billion to allocate, with very broad authority on how to use it - so there will be a need to set goals and priorities for that significant allocation immediately.

In addition to potential new uses of roughly half of the TARP, the first item on the agenda when Congress returns to Washington after the New Year is likely to be another economic stimulus package. Another opportunity to attempt to kick-start the economy, but also new spending that will increase the deficit, put additional pressures on the federal checkbook, and make it more difficult for Senator Obama to live up to some of his promises from the campaign trail.

Having now passed two stimulus-type packages in the past year, Congress is poised to act again. Both the House and Senate leadership have indicated that the new stimulus could include about \$100 billion in new spending. Now members of incoming economic team are suggesting new spending in a stimulus package could exceed \$500 billion.

I understand the need to act -- but I do have deep concerns both on the spending and tax side, and here's what they are: Based on what we have learned in the past, any jumpstart should ensure that new spending is immediate and temporary - - without mid and long term obligations that substantially deepen the deficit - - and that any tax relief is view as more

permanent – so it can be relied upon. To incentivize the right behavior, tax cuts need to give provide investors and risk takers the certainty that they need.

From reading the tea leaves, I fear Congress and the incoming Administration may be looking at doing just the opposite with some or all of a new stimulus package. And I fear that too much spending that is not immediate but entails longer term commitments, and temporary tax relief or rebates, may only serve to lengthen the negative business cycle we are now in.

Let me give you a specific example on the spending side. In the recent \$100 billion stimulus proposal from the Senate Democratic leadership, \$37 billion is set aside for infrastructure spending. Such spending is popular with Republicans and Democrats alike. The Congressional Budget Office recently estimated that less than 1/3 of such new infrastructure funding would be spent in the next year.

Of course, as a former Budget Director, I also have deep concerns over the impact on the deficit and debt – Again, some stimulus is warranted in my view, but the deficit that was \$162 billion – of 1.2% of our economy in 2007 – is now projected with this likely new spending to be at or above \$1 trillion dollars – or somewhere around 7% of the economy in 2009. Compare this to the 40-year historical average of about 2.3% of GDP.

And along with these more short-term economic challenges, the Obama Presidency will be faced with other longer-term fiscal challenges: The biggest among them is the unsustainable growth in our entitlement programs, including Medicare, Medicaid, and Social Security. We are creating IOU's we are leaving to future generations and crowding out our ability to invest in education, infrastructure, renewable energy, and national defense.

This is what I listed as challenge #2: Last year, mandatory spending on entitlement programs made up over half (53%) of the federal budget, and it is growing at a faster rate than the rest of the budget and well above inflation. While these programs play a critical role in our society, reform is necessary if they are to be around for our children and grandchildren.

Interest payments on our federal debt made up another 9% of the budget, so

in a sense, 62% of the budget is on auto pilot. This 62% of the budget compares to only about one quarter of the budget when Lyndon Johnson assumed the Presidency – and it leaves Congress with only 38% of the federal budget to allocate toward other federal programs through the contentious appropriations process we hear so much about - and more than half of that goes to Defense.

Here's another way to look at it. Without reform, and assuming current revenues, this mandatory spending will consume our entire budget in less than 30 years. There will be nothing left for education, or defense – or operating the federal government. And, of course, the sooner we begin appropriate reforms the better to avoid some of the personal or economic dislocations that would otherwise occur.

For the students with us today: Don't allow the understandable focus on our immediate problems to paper over these very real fiscal challenges just around the bend that threaten the dreams and promise of your generation. I believe the presidential campaigns largely avoided this issue because voters – including young voters – allowed them to.

Let's talk about a few of the other challenges listed: Health Care: Costs are rising while an estimated 47 million people are uninsured. While Republicans and Democrats may differ on the solutions, both agree that we need to lower costs and increase coverage. Point: Health care cost increases drive most of the long-term fiscal challenges I just discussed.

Energy: Of course, we also face challenges in terms of energy policy. We are currently sending hundreds of billions of dollars overseas each year for foreign oil. Here, I see common ground between Republicans and Democrats on an approach that includes more research dollars and incentives for alternative energy (including solar, wind, hydro, geothermal, and battery technology for better hybrid and new electric cars) and also for significant conservation gains. Where the new Administration and Congress will not find consensus is on the more difficult politically – but I think critical supply side – bio-fuels, new drilling, nuclear power, and clean coal technology.

I also listed the need for a workforce ready to compete. While education costs are on the rise, our education system is falling behind, especially in math and science. We have pockets of excellence, but we need to improve

our public schools through rewarding good teachers, choice and competition, and make college and lifetime learning more accessible to have a competitive workforce in the a global economy.

And along with these policy challenges and others I listed at the outset, President-Elect Obama will have serious political challenges to deal with.

Simply put, he needs to cut through the partisan gridlock that has plagued Washington if he is to address these challenges and enact legislation that is in the best interest of the American people.

In my view, President-Elect Obama has a choice – he can try to govern more from the middle on these and other tough issues, or face the likelihood of a partisan block, at least in the Senate. Yes, he can try to rely on Democrats and pick off a few Republicans on any specific issue to barely sneak past a Senate filibuster that will be strengthened after Senator Chambliss's runoff win in Georgia this week.

But the more likely outcome from this approach will be that he will be blocked by Senate Republicans and a handful of Democrats who are more conservative on specific issues. Such a strategy would also divide the country at a time when there is an urgency to bring people together.

I'm not suggesting this will be easy – If the new President works with Republicans as he has indicated he wants to do, he risks alienating the left, a key group of his supporters and the key group for the Democratic leadership in the House and Senate.

So how do these challenges we face today relate to Lyndon Johnson and his legacy? First, we need to acknowledge that Lyndon Johnson, too, faced many challenges upon entering the Oval Office, and I believe we can learn from his handling of those challenges.

The challenges were different in kind. LBJ's were more about the unraveling of the social contract than the unraveling of the financial system. And while war is once again dividing our country, the divisions are less deep than the Vietnam era. And while the economy was experiencing more growth in the 1960s,

Lyndon Johnson too faced fiscal pressures while he sought to fund an

expensive war while paying for the Great Society programs that would be his lasting legacy.

The LBJ legacy is multi-faceted and complicated, and I cannot do justice to it. But I will point what I perceive as to two specific approaches that LBJ took in response to the challenges of his time - that I believe the incoming Administration should study.

The issue of race was a major national challenge for LBJ. A politician from the South, as President, Lyndon Johnson showed both political courage and legislative skill in his role in negotiating and passing the Civil Rights Act of 1964 and the Voting Rights Act in 1965, moving our nation one step closer to equal opportunity for all. And how appropriate that we here today in an institution honoring the man who signed the law insuring the right of African Americans to vote while we discuss the future challenges of our first-elected African American President.

While we still have steps to take toward racial equality, the distance we have traveled these past forty-four years is an affirmation of the LBJ vision. The lesson here was that President Johnson was not just willing to take on a politically risky task, but one that required him to take on members of his own party – many of whom had been his allies in his Senate years. The same will be required of former Senator and President-Elect Obama if he is to successfully address the challenges of today.

The second example – one I think President-Elect Obama should also study is related to fiscal matters. For as important as it is for us to give credit for the extraordinary legislative accomplishments of LBJ's Administration (see the list in your program materials), it is equally important for us to examine the results and consequences of his policies in terms of the fiscal challenges we face today.

When President Johnson signed the Medicare Bill into law in 1965, it was sold as a self-sustaining program that would help our most needy citizens. Today, it is an expanded program on autopilot, with rising costs and an inherently flawed generational funding structure that is putting enormous pressure on the federal budget.

We've talked about the Medicare impact on the aggregate budget, but look at Medicare's own fiscal crisis. The best estimates (based on "intermediate assumptions") say that annual payments from the Medicare HI Trust Fund will exceed its annual income beginning in 2011. When this happens, the "reserved" money that has already been "set aside" will have to come from the general funds. (Because the general fund has basically written very large IOUs.) These program deficits will increase in 2019, when the Trust Fund balances will likely be completely depleted.

Medicare's problems are caused by a number of factors. First, health care costs are rising faster than inflation. Second, new technology leads to more expensive procedures, and with the federal government footing the bill, people will continue to buy them regardless of the cost. The third reason is a great problem to have – people are living longer. Fourth, it is a pay-as-you-go system where, like Social Security, current workers are forced to pay for the benefits for a larger and larger baby boom group of retirees.

These factors have led to drastic and unsustainable increases of the Medicare program. In 1967, Medicare made up about 3 percent (3.4 billion in outlays) of the federal budget. 1970, Medicare made up about 4 percent (\$7 billion in outlays) of the federal budget. In 2007, it made up 16 percent (\$432 billion in outlays).

Also related to fiscal responsibility and our long-term economic health is Social Security. And while Social Security was created before Johnson came into office, President Johnson made two key changes. First, he increased benefits by 7% as part of the Medicare bill in an effort to make it more attractive for members of Congress. Second, he was the first President to use money from the Social Security Trust Fund as additional revenue for the general account the Congress budgets each year.

The Social Security Trust Funds were originally accounted as being separate from the federal budget, and the revenues coming in were to be saved for later use. For those of you who have taken some public budgeting classes Social Security was originally an "off-budget" account. In 1969, at the recommendation of the President's Commission on Budget Concepts, President Johnson became the first president to propose a unified budget in which the Social Security revenues were "on-budget," and included in the overall picture. While in many respects, this "all revenue in" way of accounting makes the big picture easier to understand, it also misrepresents

the true picture.

Social Security is currently running surpluses, but as the baby-boomers retire, a shrinking workforce is paying for a growing number of retirees. In 2006, the surplus was \$199 billion. As early as 2017, Social Security will begin to pay out more in benefits than it brings in through payroll taxes and will have to start using the money it has lent the federal government by starting to cash in some of the unfunded IOUs. However, if we continue the status quo, even the trust funds will be exhausted by around 2041.

Social Security consumed about 14% of the budget in 1964. In 2007, it was 21% of our federal budget, and like Medicare, its autopilot growth cannot continue unaddressed.

Clearly, in order to get our fiscal house in order we must reform these critical programs. I am not laying the blame for these fiscal challenges on the LBJ years. The longer term fiscal impact is always impossible to predict with any certainty, and the Presidents and many Congresses that have succeeded LBJ have had ample opportunity with new data to act responsibly.

But the lesson, and the point, really the same one I discussed at the outset today, is that President-Elect Obama should very carefully examine the long-term fiscal implications of any new public policy.

Let me finish by suggesting that perhaps the most important legacy of Lyndon Johnson is that he demonstrated as much as any American that through commitment and political courage – you can make a difference.

Our 26th President, Teddy Roosevelt once said, “It is not the critic who counts; not the man who points out how the strong man stumbles, or where the doer of deeds could have done them better. The credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood; who strives valiantly; who errs, who comes short again and again...who spends himself in a worthy cause; who at the best knows in the end the triumph of high achievement, and who at the worst, if he fails, at least fails while daring greatly, so that his place shall never be with those cold and timid souls who neither know victory nor defeat.”

As Lyndon Johnson might say, it is easy to criticize while watching from

afar, but it takes much more courage and the reward is much greater when you actively get involved, as many of you are doing today.

Many of our politicians' faces may be marred by dust and sweat from policy and political battles, but - like LBJ - are in public service for the right reasons. If we can work together, no challenge is too great.

Thank you, and I look forward to your questions.