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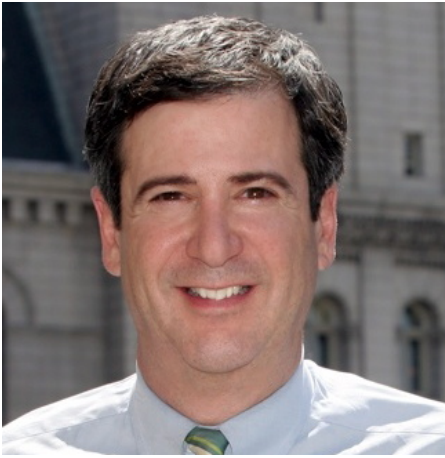
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Cutting the Deficit: What Comes Next?

By
Claire Lambrecht

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(MoneyWatch)



The initial members of the deficit reduction "super" committee [have been named](#), and soon their task will turn to coming up with a bipartisan plan to cut up to \$1.5 trillion from the nation's debt over the next 10 years. If they fail, automatic cuts to hundreds of defense and domestic programs will ensue. With so much at stake, both politically and for the nation's economic future, what are their [chances of success](#)? For insight, MoneyWatch turned to Robert Shapiro, the U.S. Under Secretary of Commerce for Economic Affairs from 1997-2001, and now the chairman of the Washington D.C.-based economic advisory firm [Sonecon](#).

MoneyWatch: Do you think that the bipartisan "super committee" will succeed in coming up with \$1.5 trillion in cuts?

Robert Shapiro: I think they probably will. I don't think it will all be cuts. I think that there will be significant revenues in it. The reason is that the Democrats will not agree to anything without revenues, and without revenues, there will be significant cuts in Medicare and very large additional cuts in defense. The argument within the Republican party is essentially going to be "Are we willing to raise taxes to preserve defense?" I think that will be a compelling argument for the Republicans. It was a compelling argument for Ronald Reagan.

Everyone will focus on who's on the super committee. But apart from a few requisite required ideologues, it's comprised mainly of people who will decide what to do based on the political ramifications. That basically means, will the public support or punish us for what we did to solve it, or for not solving it? Since the public supports a balanced approach, including more revenues from high-income people and corporations, we should get an agreement with revenues. Unless, of course, the radicals figure out a way to block it, as they held up the debt limit.

MW: What happens if the panel is not able to come up with a solution?

RS: We have mindless cuts. That is, cuts that are across the board. The effect of cuts on particular programs, in that sense, is mindless. The only major things that are exempt are Medicaid and Social Security. Medicare is not exempted, nor is defense. So if you've got across-the-board cuts, those are the biggest cuts because those are the largest programs. Defense, for example, would absorb \$500 billion of the \$1.5 trillion in cuts.

MW: Is that something that both parties will want to avoid at all costs?

RS: It's certainly something that traditional conservatives are going to want to avoid at all costs. It depends on the politics of it. Substantively, yes, it's something both parties will want to avoid at all costs. If the Democrats make an effective case that the Republicans are holding this up by refusing to increase taxes on hedge fund managers and wealthy companies -- which has been the argument -- then, politically, the Republicans become responsible for the Medicare cuts.

MW: If the panel is able to make the required \$1.5 trillion in cuts, is that going to succeed in significantly reducing America's deficit?

RS: Yes, of course it does. You have near-term deficits, which we should not be decreasing. You have the medium term deficit, which is out another ten years, and then you have the long-term deficit. This deal essentially addresses the

medium-term deficit, and if there are revenues, it also should address part of the long-term deficit. We have to rebuild the revenue base. Over the long-term, of course, you'll require more reforms. You always do.

MW: So this is something we've dealt with before.

RS: Look, this is never a process that is settled for more than a couple of years. The needs of the country change, the politics of the country change, and we adjust. Actually, we've shown a great capacity to do that. Even with the irresponsibility of the Bush administration, in both spending and revenues -- spending particularly with regard to Medicare Part D, the only entitlement program ever enacted without a significant funding source -- had they not also so mismanaged the economy that we had a financial crash, we could have handled this [structural deficit] without an enormous amount of difficulty.

We addressed structural deficits in the 1950s, we addressed it in the 1980s, we addressed it in the 1990s. We could have addressed it this time, too. The economic crisis enormously increased the sense of urgency of it. I don't have any doubt of our capacity to address this, and neither do financial markets. Throughout this whole process, long term interest rates have been actually trending down. That tells you the confidence of global investors in our capacity to do this.

MW: How do you think the ratings agencies will respond to the panel's recommendations?

RS: The fact is, I don't think the rating agencies have much influence at this point. Their record in the financial crisis was miserable. They made large-scale and consistent mistakes in the ratings of mortgage-backed securities. Moreover, while they have been raising alarms in recent weeks, [bond] markets have shrugged them off. And I don't think that the other agencies will follow S&P's move.

S&P's decision, frankly, is a little suspect. There is no prospect that the United States would be unable to meet its obligations, now or in the future. The structural features of the economy are strong once we get past our current problems, and our capacity to generate the necessary revenues is huge. In addition, we pay in dollars -- and we can always print money. S&P deserves a passing grade only in one respect: They focused on the current political dysfunction to justify their decision, not the underlying economics. In effect, that makes it, as some politicians have said, the Tea Party downgrade. But the truth is, there shouldn't have been a downgrade. In any case, the market rejected S&P's view: Even as S&P downgraded, the price of U.S. Treasuries continued to rise and their yields continued to fall. That was a clear vote of confidence from global investors.

MW: What are the consequences if we are not able to reduce our deficit significantly?

RS: It's hard to imagine how we wouldn't reduce it by at least the dimensions of this deal, because it has a fall back [in the automatic cuts]. It's possible that Congress could suspend the fallback. That's possible. We don't know how the economy is going to evolve. It could be that putting these cuts in place in two years could be very counter productive. The economy could be in trouble from Europe, in particular. So I don't think there would be a consequence; I think that if we delayed it because of economic reasons, that the markets would say, "That is the intelligent thing to do."

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








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