THE ECONOMIC CLUB OF WASHINGTON, D.C.

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DAVID RUBENSTEIN: We're very pleased to have this evening as our special guest, Jack Lew, who is the Director of the Office of Management and Budget. Jack is somebody I've known for about 35 years, I guess, because I knew him when he was a relatively young staff person on Capitol Hill.

Jack is a native of New York, graduate of Harvard College. After he graduated from Harvard College, he came down to work on Capitol Hill, working for Tip O'Neill and worked on Tip O'Neill's staff for about eight years, rose up to be the head of policy development planning for Tip O'Neill. After about eight years with the Speaker, he left to come practice law in Washington with Van Ness Feldman & Curtis.

He practiced law for five years and then came into the Clinton Administration where he originally worked in the White House as Special Assistant to the President in certain policy areas, including AmeriCorps. He helped to draft the legislation for AmeriCorps and then went to the Office of Management and Budget where he rose from Executive Associate Director for OMB to Deputy Director of OMB to the Director of OMB. He served as the Director of OMB from 1998 to 2001.

During that period of time, the United States Government had the largest budget surplus in our entire history. (Applause.) During his last year, the U.S. Government had a budget surplus of $236 billion and we have never beat that since and may not.

After he left the administration at the end of the Clinton Administration, he went to NYU where he was Vice President for Operations of NYU and also taught at NYU. Later, he joined Citicorp and became the COO of its alternative investment management business. At the beginning of the Obama Administration, he came into the administration as Deputy Secretary of State for Operations and Management. And then he took the position recently of being the Director of OMB again. He's the only person in history who's held that job twice.

So Jack, my first question is the obvious one. If you went from having the highest budget surplus in history and a record that's not likely to be topped any time soon, what made you think that it would be a good idea to come back and be the head of OMB again and preside over some very large deficits?

JACK LEW: Thanks for having me here tonight, David.

MR. RUBENSTEIN: Thank you. (Laughter.)

MR. LEW: I like challenges and this is certainly a challenge. You know, when the President asks you to take a job that you had before, your instinctive answer is, why would I want to do it again. And when the President makes a case that he needs you because he needs somebody with the experience to hit the ground running and he needs you to do it, it is very hard to say no.

MR. RUBENSTEIN: Okay, so how many times did he have to ask you?

MR. LEW: That's between me and the president. (Laughter.)

MR. RUBENSTEIN: All right. Okay, so what is the principle difference between being the head of OMB before and now? How has the job changed, other than the obvious budget surplus issues?

MR. LEW: Obviously, leaving after three years of surplus which did not happen by accident – we had a long period of time when we were focused on deficit reduction and proved that you could actually eliminate a deficit and turn a surplus – but leaving after three years of surplus, coming back with a deficit that is larger than any we ever imagined – the day I left office, I testified with the Senate budget committee and projected a surplus of over $5 trillion over the next 10 years. When I came back, there was a deficit projection of over $10 trillion over the next 10 years. It can't get much more different than that.

MR. RUBENSTEIN: Right.

MR. LEW: I think a number of things have changed, apart from the dimensions of the budget problem. Part of it is the kind of change that's being experienced throughout the economy. Information flows much more quickly. Technology has made it so that there's instantaneous analysis and conveyance of information which actually takes a process that was always very stressful and high-stakes and made it even more so because there's this constant flow of information.

MR. RUBENSTEIN: Well let me ask you under – can you contrast how President Clinton dealt with the head of OMB with President Obama? Did Clinton get into the budget issues and does Obama get into the budget issues? How much interaction do you have with the president on the budget appeals?

MR. LEW: Well, budget appeals are kind of a narrow part of the interaction you have with the president and his budget director. It's kind of one part of the year and I would say that, in both cases, I considered it a mark of some success to keep the number of appeals to a small number – in fact, very few, if any.

The truth is if the president conveys to the Cabinet that the shape of the challenge – the same as the shape of the challenge that the OMB director is describing – then it gets to a question of, you know, is there a meaningful appeal.

MR. RUBENSTEIN: Does anybody go around you?   In other words, they ever call the President and say, the OMB director is terrible and I have a better position on this?

MR. LEW: I would say that there are – there are occasions when Cabinet members want to be heard. But I've been privileged to work for two presidents who support their OMB director.

MR. RUBENSTEIN: Okay. All right, so this year under the budget that the president proposed and you developed, the projected deficit for FY ’12 is what number?

MR. LEW: We projected at $1.6 trillion. Estimates are now coming in lower than that, closer to 1.4 (trillion dollars). Either way, it’s a very large number.

MR. RUBENSTEIN: So $1.4 trillion deficit –the tax revenues are roughly 2.6 trillion (dollars)?

MR. LEW: Yes.

MR. RUBENSTEIN: So we’re borrowing about 40 percent of the budget?

MR. LEW: Yes, it is a record deficit and it’s the reason why there is a bipartisan consensus right now in Washington that we need to focus on deficit reduction in a very serious way. I think that if you look at the size of the deficitright now, it doesn’t tell the whole story of how we got there. I mean, having left 10 years ago with a huge surplus, there were a series of decisions made on policy grounds – tax cuts and new benefits like prescription drug benefits that weren’t paid for.

MR. RUBENSTEIN: Right.

MR. LEW: And that essentially eliminated the surpluses.

Then there were wars that weren’t paid for and an economic decline that had two impacts on the deficit. One is that it drove down revenues because less growth means less income, less taxes. And it also required very substantial intervention because without stimulus we wouldn’t be experiencing the recovery that we’re now experiencing.

The net result when I came back on the scene was a deficit that was bigger than one could ever have imagined 10 years ago.

MR. RUBENSTEIN: When you left government before, there was a concern in some circles that we would pay off all the government debt and there would be no Treasury bills against which corporate debt could be measured. That’s not a problem any longer but – (laughter).

MR. LEW: Almost nostalgic to hear that argument reprised. (Chuckles.)

MR. RUBENSTEIN: Right. But to go back, right now the budget problem in Washington, or the debate in Washington, seems to be whether we should cut out $4 trillion more or less of spending. I think your proposal was to cut out 4 trillion (dollars) spending over 12 years.

MR. LEW: Right. Our proposal is 4 trillion (dollars) of deficit reduction, roughly 2 trillion (dollars) of spending, 1 trillion (dollars) of revenue and 1 trillion (dollars) of saved interest.

MR. RUBENSTEIN: Okay. If you do that, if you got everything you want, you're still adding $10 trillion to the deficit over that 12-year period of time. So if we have 14 trillion (dollars) today of debt, and then you add another 10 trillion (dollars) or so in the next 10 years, how are we better off with this $4 trillion reduction?

MR. LEW: When you're talking about numbers that are this large, it takes a long time to dig yourself out of the hole. The first challenge is stabilizing the deficit as a percentage of the economy. So we get to the point where debt stops growing as a percentage of GDP. Our proposal, were it adopted – now, obviously there's not a process of parliamentary government here so we know it's not going to be adopted in every detail that we proposed.

(But our proposal) would bring the deficit down to roughly 2.5 percent of GDP which would accomplish the goal by 2015 and then lower by the end of the decade. I think that if we look in that range of $4 trillion savings over the next 10 to 12 years and really accomplish it, we can get the deficit to the point where we're looking out and instead of seeing the debt growing ultimately to 100 percent of GDP, we can stabilize it and then you can make additional policy decisions to bring it down in the long-term. You've got to take that first very important step.

We call it a down payment. I think the down payment understates what it really is. It is critically important. And we need to take that action now. It's not something that we should wait two or three years to do.

MR. RUBENSTEIN: At the end of the last Congress in the lame-duck session, the tax cuts were extended. The so-called "Bush tax cuts" were extended. That added, I don't know. $1 or 2 trillion to the –

MR. LEW: $800 billion.

MR. RUBENSTEIN: $800 billion, sorry, and why would you as the OMB director support that? Wouldn't that just add a lot to the deficit? Why not just eliminate those cuts?

MR. LEW: We are in a very sensitive moment in terms of economic transition. We are no longer in recession. But we're in a recovery that is not something we can just take for granted. In December, had there been no tax bill, what we would have seen on January 1st was a tax increase right at the time when you were seeing job creation and economic growth beginning to settle in. We feared, and I think we feared correctly, that were that to happen, we could have had a double dip.

And that would have been a terrible thing for the economy. It would have been a terrible thing for fiscal policy because one of the engines that we need in order to get out of this deficit hole is economic growth. Without economic growth, you can't cut your way out of the problem because one of the problems was the economic decline. I think that the balance in the tax bill in December is one that did a lot to stimulate the economy.

There's a payroll tax holiday. There's an extension of refundable tax credits for people who are sending their kids to college and for the earned income tax credit. There was an extension of unemployment insurance benefits. These are things that had immediate stimulative effects.

Now, we made no secret of the fact that we did not support the idea of extending the tax cuts at the high bracket. It was a compromise to do it for two years where one side said at the end of the two years it should go away and we should go back to the tax rates which were in the 1990s – the tax rates we had when we had the longest period of uninterrupted economic growth in our history.

So we think they were tax rates highly consistent with stable growth. The other side would like to see them made permanent. We're going to have a chance to have that debate.

MR. RUBENSTEIN: Right.

MR. LEW: But last December was not the time to kind of throw the gears into reverse on the economy. And that's what we would have faced had there not been a compromise. It was an honorable compromise.

MR. RUBENSTEIN: And the President's position, I think, in the campaign was that he didn't want to have any tax increase above – for people below $250,000 and to protect the middle class. But people who make $250,000 and above are only 2 percent of the population. So the middle class presumably is $100,000 or something like that. So if you want to protect the middle class, why would you not reduce or increase taxes on people above $100,000 because 250 (thousand dollars) is well above the middle class.

MR. LEW: I think that if you – if you look at where the middle class lies, you'll get a lot of different explanations. I've had people argue it's well above 250 (thousand dollars) when they argue. We drew the line too low. I think if you look at the tax brackets, 250 (thousand dollars) is the dividing line between the top bracket and the bracket below it.

And what we said was that it was not necessary to raise taxes – to keep the tax cut in that top tax bracket. We also by putting a plan together that accomplishes $4 trillion of deficit reduction showed you don't need to raise taxes on people below $250,000.

MR. RUBENSTEIN: Okay.

MR. LEW: So you know, we're obviously a long ways off from getting a bipartisan agreement on the future tax policy for the country. But I think we've made it clear that shared sacrifice means that people who have been lucky enough to be in the top tax bracket have to bear part of the burden. The cuts that we're making on the spending side fall disproportionately on people below that line.

So it's not a question of who are good people and who are bad people. The President was actually quite careful when he made his remarks just about six weeks ago at George Washington University to make it clear that this was a question about everything being on the table so that we have the kinds of choices that can be balanced. And for people who have been lucky enough to be in that tax bracket -- actually he talks to them -- don't complain that much about their tax rates.

MR. RUBENSTEIN: Okay. So let me ask you -- when people talk about a budget cut, do they really mean a cut below what the projected increase is going to be or a real cut? Right now for example, when you talk about budget cuts, are you really talking about cuts below what the current spending is or below what it would otherwise grow to?

MR. LEW: For different purposes, you talk about it in either way. When we look at what projected deficits are, projected deficits are based on projected growth, not on current levels going forward. So there is an assumption about inflation on things like Social Security and Medicare. There are assumptions about more people being eligible. And any changes you make to that baseline give you savings for deficit reduction.

MR. RUBENSTEIN: Now, if somebody represents, let's say, a business interest and they want to come to see you, can they just call up and come in and lobby or do you – you don't meet lobbyists I assume? Or how do people influence you?

MR. LEW: Well, I seem to have a schedule that's full from 7:00 in the morning until 10:00 at night. So a lot of people see me. (Chuckles.)

MR. RUBENSTEIN: Okay.

MR. LEW: I meet with groups more than with individuals. But I will meet with people who have serious issues to raise. And I mean, my frustration is that your time is so filled up with internal meetings and things that take up 80 percent of the day that you sometimes feel like you're in a cocoon and you have to struggle to hear things that aren't just the same people that you talk to in those meetings that you really must be part of.

MR. RUBENSTEIN: Now, the Congressional Budget office, they have projections of deficits and inflation rates and economic growth and you have yours. Whose are more accurate? (Laughter.)

MR. LEW: All projections have risk of error. When I was at OMB the last time, my errors were always underperforming. So reality was better than I projected. I haven't had a track record yet so I can't speak after just six months. You look at economic projections and they do drive these numbers in a very important way. We're pretty close. We all gravitate around mainstream kind of centrist blue chip kinds of economics.

There are sometimes one factor or another where there's a principle difference. I'll give you an example. Our assumption about long-term growth is that this recession – the recovery from it – will ultimately return us to the same level of potential GDP that we had before the recession. That's been the experience of the recovery from every previous recession including every financially-led recession.

The Congressional Budget Office assumes that here's some permanent loss of potential in the economy. That's a legitimate difference. Our assumption is in the mid-range of the Fed's assumptions. Theirs are within the mainstream as well. We don't know sitting here today who's going to be right.

Our view is if you make the right policy, the United States has always returned and we don't think anything about this recession should make us bet on the opposite. So that's a principle difference and I'm happy to debate it. This year we're a little below them in some things. Over time it kind of evens out.

MR. RUBENSTEIN: What are your projections now of what the unemployment rate would be in, say, November of next year?

MR. LEW: Well, I don't remember the year-to-year unemployment projections or any other year-to-year projections. We show it trending down. We show growth trending up.

MR. RUBENSTEIN: You think you can get below 8 percent?

MR. LEW: We obviously would like to get unemployment as low as we possibly can as quickly as we possibly can. It is the principle thing that the American people are looking to us to be worried about and every day we worry about the unemployment rate.

MR. RUBENSTEIN: Well, when you were in the government the last time, a budget deal was cut between the congressional Republicans and the Clinton Administration that led, I guess, to the budget surplus. And what was the key to getting that deal done and do you see the elements of a similar deal this time?

MR. LEWIf you look at what was the environment we were in then, in some ways it was less likely then than now. There was certainly a sense of common purpose; I think a process of building up relationships over a period of many months made it possible for us to explore what was in our common interest.

But I don't think there was an impending sense of crisis. It was a sense that it was the right thing to do and it was a very good thing that we did it. I think right now we're in a situation where the whole world is watching to see will we be able to get our fiscal house in order. There was a lot of understanding that we had to worry about the recovery through the end of last year.

So I don't think that the tax bill that you asked about earlier caused a lot of eyebrows to go up in the world economic community. As we're in a recovery, as we're looking out at these deficit forecasts, there's a sense that we have to start taking action now because it takes a few years for things to kick in. And if we want fiscal consolidation to be hitting at the point when it really should, waiting until 2013 means waiting until 2015 or 2016.

MR. RUBENSTEIN: Right.

MR. LEW: And I think you look at things like the Standard & Poor's evaluation that came out a few weeks ago – very interesting document. Fundamentally, as an economic document it. said the United States had a AAA credit rating. As a political analysis, they said, we're afraid that no action will be taken now and that if no action is taken now and it's put off until 2013, we're worried that it will get beyond the point when action needs to be taken.

Now, I'm not saying that that's a reason for us to act today versus six months or a year from now. But I think it reflects a real concern that the political environment in Washington could stand in the way. And I think one of the things that is very promising in the conversations that are going on now –the vice president is leading –

MR. RUBENSTEIN: Are you involved in those?

MR. LEW: I am involved in those – is that there is a shared sense of purpose in those conversations. I think you look at everyone came in with the same definition of the problem. We all said we need to do something that is roughly $4 trillion. Whether it's 10 years or 12 years is a detail.

Four trillion dollars of deficit reduction is something we agree on. We're now engaged in a process where I think there is a lot of trust being built up so that you can discuss serious options. There is a need to act because we all know it's not going to be easier to act six months or nine months from now than it is now. So I'm actually – not with standing the difficulty of the problems -- optimistic.

MR. RUBENSTEIN: When do you think a resolution of the Biden-led discussions will be made public?

MR. LEW: Well, I think, we're now, -- because of all the scheduling complexities -- going into what's essentially the third week of discussions. I think we have a lot of work ahead of us. I think quite a few weeks of conversations.

MR. RUBENSTEIN: Where do they have those discussions?

MR. LEW: We've been meeting at Blair House. Tomorrow, the meeting will have to be moved because we have a foreign visitor staying in Blair House – the Prime Minister of Israel is staying in Blair House.

MR. RUBENSTEIN: So where will you go now?

MR. LEW: We will find other very appropriate accommodations. (Laughter.)

MR. RUBENSTEIN: All right. And now, you're going to have – even if you get your 4 trillion (dollars), you're still going to have 20-plus trillion (dollars) of debt. Is that right?

MR. LEW: Yeah.

MR. RUBENSTEIN: And then if you have the Fannie Mae and Freddie Mac on top of that, maybe 25 trillion (dollars). As a percentage of GDP, won't it still be pretty large?

MR. LEW: It is large, but if it stabilizes, it will, I think, be possible for us to send a very reassuring signal both to markets and to taxpayers that we will be able to work our way out of it. It takes a long time to bring down accumulated debt. We only – in the years that we were balancing the budget in the 1990s – worked our way out of the deficits that were built up in World War II.

MR. RUBENSTEIN: Right.

MR. LEW: I don't think you can realistically think that you can take a deficit this large and eliminate it in one kind of – one negotiation or one cycle. You can arrest it in terms of the deficit as a percentage of GDP driving it forward. And then you get it in the right direction and that's what we're aiming to do.

MR. RUBENSTEIN: The defense budget now is roughly – is it 800 billion (dollars) a year or something like that?

MR. LEW: If you count the regular defense budget plus the special appropriations for what are called contingency operations or -- wars.

MR. RUBENSTEIN: Okay, so $800 billion. Do you see a need to reduce that dramatically to get to where you want to go?

MR. LEW: The President proposed, when he put his framework out, that we look for savings in every part of the budget. In the security part of the budget, he said that we have been successful – Secretary Gates has been successful -- over the last two years making roughly $400 billion of savings in the defense budget. He said we could do that again.

We could get another $400 billion of savings in the security area. And we're now in the process of a review. It will require strategic review because to do it again will be difficult just looking for low hanging fruit. But we're now in– the secretary had comments on this last week launching the strategic review. We're working very closely together on it.

MR. RUBENSTEIN: So what is the best way for a Cabinet officer to win an argument with you? What is the – what's the best – what argument do you like the best?

MR. LEW: Well, I tend to believe in facts and clear analysis. So if you start with facts and clear analysis and less emotion, it tends to work better with me.

MR. RUBENSTEIN: Okay.

MR. LEW: Arguments to begin with – your staff messed this up – aren't the best way to start the conversation. (Laughter.)

MR. RUBENSTEIN: Well, does anybody do – I think Cap Weinberger under Ronald Reagan, when he wanted to get more defense spending, he would show these charts to Ronald Reagan with pictures of soldiers and show a lot of military soldiers and I guess it got President Reagan really interested in it. Does anybody come in with pictures and illustrations that really are effective?

MR. LEW: Nowadays everybody has decks. No one writes memos anymore. Everything's PowerPoint and slides. You can make a clear argument with no pieces of paper. You can make it with a memo. You can make it with slides. Clear thought is clear thought.

MR. RUBENSTEIN: Does anybody ever make the argument this is so small it doesn't make a difference so you should approve it?

MR. LEW: Sure. Everything is small when it's yours and it's large when it's someone else's.

MR. RUBENSTEIN: Right, right. (Laughter.) And, like, does the president go through the budget appeals in the Cabinet room and are there a lot of those every year?

MR. LEW: The challenge when you're dealing with something as vast as the federal budget is to find the right level of detail to share with the president on a regular basis. Having now worked for two presidents, every president has their own style. I had the privilege to work for two presidents who are smarter than I am.

So it's not very hard to get them into a serious discussion on almost any aspect of the federal budget. Their level of knowledge and interest and curiosity – the challenge is you don't have enough time to do that with everything.

I've found over the years that if you can give a clear overview and then go department by department showing what's changed and what is potentially controversial, you can direct the conversation to the things that really warrant presidential attention and flag the things that they would want to know more about.

The danger of trying to take every issue to the president is you just don't have time and you don't end up using the president's time on the things that really are decisions that he would want to give clear separate direction on. Any member of the Cabinet could raise an issue with the president. So you're never taking the Cabinet member's opportunity away. I'm pleased to say that it's rare that – very, very rare -- that Cabinet members have had to go to the president.

MR. RUBENSTEIN: And do members of Congress lobby you as well?

MR. LEW: You frequently get letters and phone calls from members of Congress, yes.

MR. RUBENSTEIN: And what's the most effective argument they can make?

MR. LEW: Again, I think. in general, the more on the level arguments are -- what the importance of something is, what the facts are, what the case is -- there's no reason to be embarrassed to say that something is important to the economy in your district.

If it's rooted in a serious analysis, to say that a project has more benefits than costs *{then when}* when you look at the analysis and it turns out to be the opposite. *{it}* is not a very compelling argument. To say that even though there may be other projects that appear to be more worthy than this one is particularly important because it tends to be a more compelling argument.

MR. RUBENSTEIN: Do you envision any chance of a debt bill not getting passed – the debt limit bill?

MR. LEW: No.

MR. RUBENSTEIN: So it will pass?

MR. LEW: I think that -- having now been to quite a number of meetings with most of the leaders of the House and the Senate -- there is a shared understanding that it is just unthinkable for us to default on the U.S. full and faithful backing.

MR. RUBENSTEIN: But it will wait to the last possible minute. So when is the last minute? Is that August?

MR. LEW: I can't argue that it will be pretty. Things rarely happen early in Washington. I actually think this is one where there is a very strong reason to do it sooner rather than later. We saw in the final days of the debate over the fiscal 2011 funding -- as we were potentially heading towards a government shutdown – we literally saw the whole world watching countdown clocks to when the federal government would shut down or not.

It would be a terrible thing if we end up with that kind of watch for is the United States going to default -- is the United States going to,for the first time in its history, be bankrupt essentially.

MR. RUBENSTEIN: Did you think there was going to be a government shutdown recently?

MR. LEW: I did not.

MR. RUBENSTEIN: Okay, and so you told all your employees to come into work and everything?

MR. LEW: I actually tried very carefully to tell my employees the same things that we told every other federal employee. And it annoyed some of the people at OMB who thought I should maybe tell them something that was the inside scoop. We were telling all federal employees the same thing. We believed – and we turned out to be correct – that there wasn't going to be a shutdown.

At the very, very end -- in the last days when there was the chance that even if no one wanted a shutdown, because the process might just get jammed up -- we went into a mode of communicating a higher level of risk.

We tried very hard to keep the issue from becoming kind of prematurely one of a sense of panic. It was in no one's interest for the government to shut down and that was borne out by the actions that were taken.

MR. RUBENSTEIN: But did you think there was going to be a government shutdown in the Clinton Administration when it actually happened?

MR. LEW: I think it's a little different because – and I'm looking at a friend of mine here that we were on opposite sides of this one. I think there was a decision in that case by one side that it might be a good strategy to shut the government down. And that made it, I think, harder to avoid. I was hopeful we could avoid it then. I never thought it was a good idea.

I wasn't particularly surprised in the '90s when it backfired and turned out people weren't so happy when the government shut down and they couldn't get a passport, they couldn't take their family vacation toa park, they couldn't rely on the fact that basic government services would be provided in an uninterrupted way.

So I think we saw again in these last few days leading up to the final resolution without a shutdown that it made people very anxious, for good reason. I mean, we should be able to get our work done.

MR. RUBENSTEIN: Now, entitlement spending, what percentage would you say – you have the $3.750 trillion budget proposal. What percentage of that is so-called entitlement spending that you just can't cut right now?

MR. LEW: Right. The two major areas are health and Social Security. Each of – health – Medicare and Medicaid are about 20 percent. Social Security is about 20 percent.

MR. RUBENSTEIN: So that's 40 (percent)?

MR. LEW: That's 40 percent. Another group of programs which get far lessattention -- things like agriculture programs, other retirement programs. That's about 17 percent. Overall, if you look at the things that are not annually appropriated, that you have to go in and change the law in order to have them operate differently, it's more like 57 percent.

MR. RUBENSTEIN: It's 57 percent and what percentage is defense spending?

MR. LEW: Twenty-four (percent).

MR. RUBENSTEIN: So 57 and 24 (percent), that would be about 81 percent. So you've got –

MR. LEW: So discretionary spending -- the thing that everyone looks to, to solve the problem -- is 12 percent of the budget. The other 6 percent is interest.

MR. RUBENSTEIN: Okay. So you have 12 percent to play with. That's all you can really change.

MR. LEW: Well, in the appropriations process for non-security spending –that's why we always made the case when you look at a deficit as large as we're looking at -- if you're talking about a deficit that's roughly $1.5 trillion and all of the non-security spending is only several hundred billion dollars, there is no way you can solve the deficit problem no matter how much you cut non-security spending.

Now, we thought it was important to reduce spending in the non-security area. That's why we reached an agreement where there was $38.5 billion of reductions from last year's appropriations;$78.5 billion of reductions from the President's budget for 2011. It's also why we say we've gone pretty much to the edge. There's not a lot more to cut without going into things that really undermine our future.

And it's going to be a question of how you balance the tradeoffs. One of the reasons that everything has to be on the table is, if you try to solve this deficit problem with anything off the table, you'll end up with choices that are frankly the wrong policy outcomes.

So if revenue is not on the table, it pushes you to go deeper into discretionary spending and entitlements. You take entitlements off the table completely, there's no way you can solve the problem just on discretionary spending. The only way this can be solved, in a way that's really in the best interest of all the people, is for everyone to bear part of the burden, for it to be truly shared sacrifice.

MR. RUBENSTEIN: Well, let's suppose you – the President were reelected and you served the entire second four years as OMB director.

MR. LEW: I thought you were my friend. (Laughter.)

MR. RUBENSTEIN: And at the end of those – that period of time, 2016, what would be the best case for the deficit? What's the lowest you think it can be in 2016?

MR. LEW: I don't want to throw a number out there. But I think that –

MR. RUBENSTEIN: Just between us.

MR. LEW: I think if you're looking as a percentage of GDP, you could see the deficit in 2016 in the 2.6 percent or below range, which would be very important.

MR. RUBENSTEIN: And what percentage is it now?

MR. LEW: Now –

MR. RUBENSTEIN: In the 20s?

MR. LEW: No, no, no, it's not in the 20s. But it's been hovering around 9, 10 (percent).

MR. RUBENSTEIN: Oh I'm sorry, the deficit. Spending as a percentage of GDP is now –

MR. LEW: Oh spending is in the 20s, yeah.

MR. RUBENSTEIN: Twenties, okay. All right, and do you think being a businessperson – you were in the business world – has made you a better OMB director or a less effective OMB director or what would you say?

MR. LEW: I actually think every experience that you have makes you more effective at what you do next. I think that having worked in the private sector, both for a university and in the financial services field, you have a different perspective on what it means to have government policy made and then to try to do your business consistent with those policies. I felt that when I practiced law as well.

I mean, the very first thing that I had to do when I went to a law firm was a client wanted to know how to go about relicensing a federal hydropower license. And I looked at the statute and it turned out it was a compromise that was deliberately ambiguous and I couldn't answer the question clearly. It gave me a whole different view on what the things you do to kind of get through the night meant when you're out in the real world just trying to make decisions and you want clarity.

That was 25 years ago and you have accumulated experiences that I think inform your judgment in many ways. I think having been in government and out of government several times – one of the things that I think for me has been most important is you kind of refresh your ability to look at problems and think about them without thinking that you know the answer already.

When I was in this job the last time, I'd been in OMB for six years and it was time for me to leave. I knew that I was probably not able to look at everything fresh. And then I came back with 10 years in between and some of the same issues come up and I know that *{I}* thought one way about that 10 years ago but it's different. The economy has changed. Is it still the same right answer? And I think you need to refresh yourself in these positions.

MR. RUBENSTEIN: When the President asked you to take this job, he didn't say, if you get the deficit down to a certain level, I'll make you Secretary of State in the second term? Nothing like that? You didn't get that kind of promise?

MR. LEW: I neither sought –

MR. RUBENSTEIN: Nor got.

MR. LEW: Nor got any commitments on the future.

MR. RUBENSTEIN: Okay, all right and what would you like your legacy to be as OMB director when you ultimately do leave? Would it be to reduce the deficit as a percentage of GDP or what would you like to see as your legacy as OMB director?

MR. LEW: I was very proud to leave OMB with a surplus. It was the first time there had been three years of surplus since Andrew Jackson was president. It's going to be a long time before somebody can say the same thing again, I think. I know that, coming in with the problems we face today, there's very little probability that I'll be leaving with a record that is as objectively strong as the record that I had the last time.

I think, by the same token, if at the end of my tenure we've stabilized the deficit, we've restored confidence that we have our fiscal house in order and that we're on a path that we can manage our business in an effective way, that's an enormous accomplishment. I wouldn't say that I'm not nostalgic for the world I left behind and that I don't have regrets for some of the decisions made in the intervening years. But you take the world as it exists today.

I think going forward, there's an awful lot we can do in the next year-and-a-half, two years, to turn things in the right direction. And as somebody who has come back to an agency that I have deep feeling for, it's been a tough time at OMB. And I want to help rebuild the agency as well. It's not easy when you're in the middle of one negotiation going into another. But OMB is one of the real crown jewels in the federal government and paying attention to it as an organization matters to me.

MR. RUBENSTEIN: How many people work at OMB?

MR. LEW: About 500.

MR. RUBENSTEIN: And how many of those are political appointees?

MR. LEW: The exact number I don't know, but it's less than 50 that are political.

MR. RUBENSTEIN: So the people – a lot of people working there before are still there?

MR. LEW: Yeah, just based on – I haven't looked at a tally -- but about half the staff appear to me to be people that I worked with when I was there 10 years ago.

MR. RUBENSTEIN: All right. We have some time for some questions. Anybody want to know what the deficit's going to be or any programs you want to ask whether they're going to be funded or not? Any questions? Right here? Just identify yourself and get a mic if you could. Here's a mic coming.

Q: Thank you. My name is Steve Vito. Mr. Lew, a lot's been written about inflation. Commodity prices have all gone up. The head of the Federal Reserve – Ben Bernanke – doesn't seem overly concerned. When you put your economic models together, what were your assumptions on inflation?

MR. LEW: I mean, our general view on inflation is not inconsistent with the numbers that the Fed looks at. We don't see enormous risks in the immediate future. But at the same token, there are very significant things going on that are creating real burdens for the American people. I mean, oil prices, gasoline prices are – they are a real problem.

And it's having an impact on consumer confidence and the like. You look across the economy at all the factor inputs – labor and where we stand vis-à-vis other countries – overall inflation does not seem to be something that we need to worry excessively about.

We do have to worry about energy prices and that's one of the reasons the President has been so determined to develop new technologies to make sure that we can safely explore U.S. fossil fuel resources and work as hard as we can to make sure that companies that are making substantial profits are doing it in a way that's not unfair to consumers. It kind of ties back to our tax policy.

I mean, one of the things that we would like to do on the tax side is take away some of the special tax provisions for companies that have benefited from oil and gas profits. We think it's only fair that when we're looking at shared sacrifice, you have taxpayers who are burdened by higher gas prices. They are also the ones who were hit when we have to have cuts in domestic spending. And it shouldn't be that it's a one-sided calculation.

MR. RUBENSTEIN: Any other questions? Right here? Time for one or two more and then we're done.

Q: HI. Paul Lawrence, Ernst & Young. When you think about the stimulus and our experience over the last two years, what have you learned about the effectiveness of Keynesian economics as a policy tool?

MR. LEW: I think that we've learned that it does work to put stimulus into the economy when you're in need of it, as we were in 2008 when we were kind of at the bottom of the recession. When you look at a stimulus package, you have to look not at a kind of random period of time but where are you at this point in time. And in 2008, we were looking at a situation where projections of the length of the recession were getting longer and longer almost by the day.

I was working during the transition period on some of the kind of thinking that went into the stimulus package ultimately. And it was having worked on several recovery packages, I'd never seen a situation where every day the sense of how long the recession would be was deepening.

Now, that changes the tools that you have available to make effective macroeconomic interventions. If you think that the recession's going to last a year or 18 months *{then}* you'll be out of it and you'll be worrying about inflation, -- that would lead you to one set of options.

In 2008, we were looking at a period of time where we knew for the next two to three years, it was going to be a good thing if there was an injection of economic activity. So it gave us the ability to do things that in a shallower recession you might not have done.

So the combination of immediately putting money into the states so that they could avoid laying off teachers and policemen and firemen at the local level, immediately having assistance go through income maintenance programs like unemployment and food stamps, to get it into consumers' hands and spent, that's the kind of stuff that you knew would have immediate impact.

Building roads and things like high-speed rail, you knew it was going to take longer. And because we knew that there was a need for economic stimulus for that period of time (I wasn't in the economic team at the time those decisions were made) it was definitely the right decision. Now, you look back and you say, right now we're seeing pretty solid economic growth. If you were to subtract 1 or 2 percent from that or take our unemployment rate and add 1 or 2 percent to that, it would feel pretty bad. And that's where we would have been without the recovery package.

So I think it's proven that it works. It doesn't mean that we don't now have to turn the corner and get our hands around our fiscal challenges going forward. But we had to get from 2008 to 2011 and I think the recovery package helped do it in a way that created millions of jobs and avoided a deeper and longer recession.

MR. RUBENSTEIN: You've worked for President Clinton and President Obama. Who is smarter? (Laughter.)

MR. LEW: They're both very smart. (Laughter.)

MR. RUBENSTEIN: You worked for Hilary Clinton and Bill Clinton. Who is smarter?

MR. LEW: You know, you talk about people at that level of smart, how do you compare?

MR. RUBENSTEIN: Okay, you're very diplomatic. Okay, one last question. Anybody else? All right, Jerry?

MR. HAWKE: After taking a look again at your résumé and seeing all of your accomplishments, which David has focused on as well, I was struck by the fact that you were a key player in the Social Security Commission.

And as I look at all these tough decisions that you have to make, it strikes me that that's the easiest area to make progress on. I would describe it almost as a lay-up. How would you describe the Social Security reform proposals that are being talked about as part of a potential package and is it one of the things that really the time is right to move ahead on?

MR. LEW: I think that it's important to separate Social Security from the broader fiscal policy discussion. It is something I've worked on for 30 years. I believe very strongly that the right time to deal with Social Security is now.

The President said that in the State of the Union. He said it in his speech just a few weeks ago. And we should work on it because we owe it to people who are working now and about to retire, for young people who are looking to retire many, many decades from now. We owe it to them to have a system that's solvent for 75 years.

In 1983, we put Social Security on firm financial footing and it's one of the things that I'm proudest of in my professional career. I think the challenge is you mix it with deficit reduction and it confuses the issue.

There are people who think that Social Security is the cause of our deficit. It's not the cause of our deficit. Social Security ran a surplus for decades. 1983 worked. The principle of 1983 was have enough income come in so that we can build up reserves and then when the baby boom retires, draw them down. Well, through that period we didn't honor that trust.

Instead of taking the surplus that we built up in the 1990s, we spent it as a country. So it's not fair to say Social Security caused the problem. Now, Social Security is obviously something that we have to deal with. As Social Security needs to draw on its reserves and those reserves aren't there because we spent them, you have to either raise revenues, cut spending or borrow money. So it's contributing to the situation.

But it's I think a fundamental mistake to say that Social Security caused it. I think it will complicate and slow the process of dealing with Social Security if the two issues are merged. Now, if you separate them, then the question is how do you deal with Social Security.

I think that it is true that if you took people from opposing views and said, you're not constrained by the kind of political arguments that your sides have made, can you identify options where reasonable people could agree, it is much easier than other areas. It's an actuarial program where you can fairly easily calculate what the income is, what the number of people is and what the outflow is.

The problem is, we're not in a place right now where a conversation can be had where everything is on the table. Revenues as well as spending have to be on the table to have a serious conversation about Social Security. In 1983, it certainly was a combination of the two.

The President, I think, laid out principles that are very clear and speak for themselves in terms of how to deal with Social Security. He very much means it when he says he wants to do it now and I think it's an invitation for everything to be in the discussion and not to start out by saying it's all going to have to come by cutting benefits.

The question has come up -- why not put a plan out. As somebody who was working for the speaker of the House in 1981 when a plan was put out, I can attest to the fact that it doesn't necessarily lead to the results of faster action. It did lead to a successful 1982 election which we were pleased about but it didn't get the problem solved.

The problem got solved through quiet conversations behind the scenes where both parties were able to float ideas without them being politically charged and to ultimately cross lines at the same moment and endorse the same package in a carefully choreographed moment. I think when we deal with Social Security it's going to require that again and the less proposals we have with everyone taking hard positions, taking things off the table, the more likely we are to solve the problem.

MR. RUBENSTEIN: Okay, Jack, I think we're out of time. I want to thank you very much for your time.

MR. LEW: Thank you, David. (Applause.)