THE BUDGET AND ECONOMIC OUTLOOK

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

HEARING HELD IN WASHINGTON, DC, JANUARY 27, 2010

Serial No. 111–20

Printed for the use of the Committee on the Budget

Available on the Internet:
http://www.gpoaccess.gov/congress/house/budget/index.html

U.S. GOVERNMENT PRINTING OFFICE

54–637 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON THE BUDGET

JOHN M. SPRATT, JR., South Carolina, *Chairman*

CONTENTS

THE BUDGET AND ECONOMIC OUTLOOK

WEDNESDAY, JANUARY 27, 2010

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to call, at 10:05 a.m. in room 210, Cannon House Office Building, Hon. John Spratt [chairman of the committee] presiding.

Present: Representatives Spratt, Schwartz, Becerra, Doggett, Blumenauer, McGovern, Tsongas, Etheridge, McCollum, Yarmuth, Andrews, Edwards, Scott, Langevin, Larsen, Bishop, Moore, Connolly, Schrader, Ryan, Hensarling, Garrett, Diaz-Balart, Campbell, Lummis and Latta.

Chairman SPRATT. I will call the hearing to order. We meet today to consider and to receive testimony from Director Elmendorf of the Congressional Budget Office on the latest update on the economy and the budget.

The numbers in the CBO report, or update, released yesterday are daunting, to say the least, but to fully comprehend the implications of those numbers, the bottom line to the budget, it is important to remember the context from which they emerge.

A year ago the economy was in free fall. Job loss was at 714,000 per month in the month of January alone. Americans' retirement savings accounts have plunged about $2 trillion between the first quarter of 2008 and the first quarter of 2009. The record budget surpluses of January 2001 have been converted to record deficits as far as the eye could see. As President Obama and this Congress began 2009, this was the context, this was the economic and fiscal legacy of the previous administration.

Too many Americans today still feel the pain of the recession. We received news today from the testimony from Dr. Elmendorf that the economy we believe is out of recession, but nevertheless there is much work to be done to rebuild the economy and to recover full capacity.

CBO's report today confirmed that the actions we have taken over the last year have pulled the economy back from the brink. CBO's report confirms that GDP will grow in 2010 and beyond, and that the Recovery Act has had a positive effect.

The report also confirmed that the recession has taken its toll on the budget's bottom line, that focusing first on rescuing the economy has meant still further cost to the budget to show up on the bottom line.

Economists agree that it is counterproductive to try to balance the budget in the midst of a deep and serious recession, and rebuilding the economy provides a critical foundation for deficit reduction. Nevertheless, the cyclical deficits we are now facing should not and cannot persist. The short-term cyclical deficits associated with this recession should not be confused with the long-term fiscal challenges we were facing even before the recession began.

Because the long-term budget situation remains unsustainable as the economy recovers, we must increasingly turn our focus to ensuring that the budget recovers as well. As we face our fiscal challenges, I am encouraged by the recent progress towards the reinstatement of the statutory PAYGO model—the statutory PAYGO rule, which we model on the rules that helped us turn record deficits into record surpluses in the 1990s. I was pleased to see the Obama administration's recent announcement that the budget proposal to be sent up next Tuesday will be characterized by restraint in domestic discretionary spending.

Clearly on both the economy and the budget, additional steps are needed. The report gives us data with which we better understand the challenges, serious as they are, which we face.

Our sole witness today is the Director Doug Elmendorf. And before turning to him for his testimony, I want to thank him and the entire staff at CBO for all the work that they do for us on an ongoing basis. By "us" I mean Democrats and Republicans. You serve us in a neutral, nonpartisan way, and you do it well. The Congress truly could not function without you.

I would also like to invite all Members to join me in congratulating the witness on the achievement of a milestone earlier this week, his 1-year anniversary as CBO Director.

Before we take his testimony, however, let me yield to Mr. Ryan for his opening statement.

Mr. Ryan.

Mr. RYAN. Thank you, Chairman.

I also want to welcome Dr. Elmendorf to the committee. You are a Democratic appointee, but I have got to tell you, I can't tell what party you come from. You have been doing a very good job of being nonbiased, objective, and that is the role of CBO Director, and you are doing that very, very well.

So I just simply want to say to you: you take a lot of flak over at CBO; there is lots of demands of your time. This year I don't think I have ever seen a year in which there is more demanded on CBO. It is a challenging economic time, and you are handling it very, very well. I know people over there are working long hours. We want you all to know that we respect that, we appreciate it, and we think you are handling yourself in a very professional manner. I might have some suggestions on how to model things differently, but I just simply want to say I think you are doing a fantastic job, and we appreciate it.

Let me turn to our fiscal crisis now, if I might. When President Obama took office, America was in the midst of a crisis that shook our financial situation to its core and eclipsed access to credit markets. The administration exploited this crisis to pursue a relentless increase in Federal spending, in the size and reach of the government. Heading in this direction has made matters much worse for our fiscal future.

Last year Congress enacted a trillion-dollar surplus—stimulus, excuse me. Last year Congress enacted a trillion-dollar stimulus, sold with the promise that would hold unemployment below 8 percent, and yet the unemployment rate continues to rise and now stands at a 25-year high of 10 percent. We learned that much of this stimulus, which was neither targeted, timely nor temporary, in fact, it was just a down payment on government programs.

Let us turn over to TARP. TARP was advertised as an emergency plan to heal financial markets with eventual return to the taxpayer. It has now become Washington's latest slush fund.

CBO's budget and economic outlook paints a startling picture of both the year we have left behind and the year we face, and the time over the next decade. In 2009, Congress delivered a $1.4 trillion deficit, the largest in our Nation's history, and no doubt because of the recession, that was made much worse. Estimates for the current year also are very staggering, $1.35 trillion deficit, and our debt will reach over 60 percent of GDP this year. Under the current policies of our government, by 2020, CBO projects that our debt will soar to nearly 100 percent of gross domestic product. Adding to that, yearly interest paid to finance this surge in spending will more than triple in nominal terms from $207 billion in 2010 to $723 billion in 2020.

More troubling than another over $1 trillion deficit is that there is more to come. CBO figures don't include what is likely to come down the pipeline this year from a request for needed war funding to the effort to jam through a new $1 trillion health care entitlement, to all of the other things that are going to happen, doc fix, and so on and so forth.

I am encouraged by the news yesterday that the administration is considering a 3-year freeze on certain discretionary spending programs. We need to see the details, and this freeze needs to be enforced with a statutory cap if we are actually going to hold the line on spending.

It is time to get serious about ending Washington's insatiable appetite for increased spending and expanded government. The promise of a discretionary freeze, although a step in the right direction, is not enough to secure our financial future.

As astounding as our current budget shortfalls are, long-term debt projections are profoundly worse. The bipartisan Peterson-Pew Commission on Budget Reform warned in its recent report that government spending, driven by the growth in health care costs and an aging population, will almost certainly bring the debt to crisis levels during the next few decades. What is once thought as a scenario that would unfold in the distant future has compounded and become a pressing issue that we must face today.

We must reform our largest entitlement programs. We used to think we had 10 or so years, but because of the financial crisis, because of the spending binge that we have engaged in, and because of the massive deficits and debt we now are confronted with, this problem is here now, not in 10 years.

We need to do this. I propose a systemic way to reform our programs. I call it a roadmap for America's future. My purpose in putting this legislation out there is not simply to say we have it all figured out, we have got all the ideas. Our purpose in putting this out is to say here is a plan to restore our fiscal future, to pay off our debts, to fulfill the mission of health and retirement security, and make our economy grow so people can have good jobs.

The purpose of doing this is to encourage others to do the same. Bring us your plans to solve our entitlement crisis. Bring us your ideas to actually pay off our debt.

There is a unique legacy in this country that is about to be severed, and that legacy in this country is each generation takes on its challenges so that the next generation is better off. Well, as CBO will tell you, as every objective statistic will tell you, we know for a fact we are consigning the next generation to an inferior standard of living. That is a fact. It is irrefutable.

I encourage you to challenge that. We have got to act, and we have got to act now, to turn this around so that we can give the next generation this American legacy of having a better future, which they will not have unless we act.

Sorry for getting a little carried away, Mr. Chairman, but this is a serious time. We appreciate the work of CBO. We need to get to work. Thank you.

Chairman SPRATT. I couldn't agree more.

Before proceeding I would like to ask unanimous consent that all Members be allowed to submit an opening statement for the record at this point. Without objection, so ordered.

[The statement of Mr. Latta follows:]

PREPARED STATEMENT OF HON. ROBERT E. LATTA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Good morning Chairman Spratt and Ranking Member Ryan. I appreciate the opportunity to hear testimony from Congressional Budget Office (CBO) Director Elmendorf on the federal budget and economic outlook. During these extremely difficult economic times for our nation's families, I welcome the opportunity to hear testimony from the CBO Director on his projections for the federal budget over the next 10 years.

I represent the largest manufacturing district in Ohio, as well as the largest agricultural district in Ohio. On the manufacturing side, my district went from being the 9th highest manufacturing district out of 435 Congressional Districts in the 1st fiscal quarter of 2008 and dropping to 15th, according to the latest numbers from the National Association of Manufacturing. There has been a consistent loss of jobs from my District, and the companies that are still in business have had to make tremendous sacrifices to remain in business.

Individuals, families, and businesses have been struggling during our nation's economic downturn, and it is very clear that jobs are desperately needed in Ohio. The latest 2009 unemployment rates for Ohio and the United States are 10.9%, and 10%, respectively, and 4 out of 16 counties in my Congressional District have unemployment rates over 14%. The American people need jobs, and I have grave concerns with the borrow and spend practices of this Congress and Administration over the past year; practices which have not helped the economy recover.

As the President has laid out his preliminary spending proposals for the next fiscal year, specifically his proposed spending "freeze", I feel his plan does not go nearly far enough to address the serious spending problem we face as a nation. The spending freeze outlined in the State of the Union address hits only the tip of the iceberg, as it applies to only a small percentage of discretionary spending. President Obama signed two omnibus appropriations bills that increased non-defense discretionary spending by 10.3 percent in Fiscal Year (FY) 2009 and 12.3 percent in FY 2010. If the President was serious about a spending freeze, he would go back to the spending levels from at least two years ago.

We are long overdue for an honest review of our spending as the U.S. again faces record deficits. CBO has stated our current budget deficit will reach $1.35 trillion. By 2020, at the current spending levels, United States taxpayers will pay $2 billion per day in interest payments alone. In addition to the current spending, it is anticipated that the Senate will pass, and soon return to the House of Representatives, a bill to increase the statutory debt limit by $1.9 trillion dollars. These spending sprees must stop. They have not assisted with creating jobs and are adding more and more burden to future generations.

With the aggressive spending that has occurred these past few years I have serious concerns with the U.S. debt held by foreign holders. Our debt as a share of the economy has jumped over recent years, from approximately 35% to over 60% this year. Given that we rely on foreigners to purchase a great deal of our debt, roughly half, I am concerned that there is a danger of reaching a breaking point on our debt levels in which these foreign investors begin to lose credibility in our fiscal sustainability and long-term economic viability. I am interested to hear Mr. Elmendorf's assessment of this current situation, and at which point the rate of debt to GDP will have negative effects on the U.S. economy.

I look forward to hearing testimony from Mr. Elmendorf today, and look forward to working with him as the FY2011 budget process proceeds. Thank you.

Chairman SPRATT. Dr. Elmendorf, once again we welcome you to the hearing today. You have prefiled your testimony, and we will make it part of the record so that you can summarize it. But you are the only witness, and unless you want to call some of your colleagues to answer questions we may put, you are the only witness today, and you should take as much time as you feel is necessary to thoroughly explain your testimony. And in that connection, I think it would be useful if you would also walk through some of the graphs you brought with you.

Thank you very much for coming today. We look forward to your testimony.

STATEMENT OF DOUGLAS W. ELMENDORF, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. ELMENDORF. Thank you, Mr. Chairman and Congressman Ryan, for your kind words about the work that we at CBO have been doing during the past year. We very much appreciate the support that you both have shown for our work during this past year and in many previous years.

To the two of you and all members of the committee, I appreciate the invitation to talk with you today about CBO's outlook for the budget and the economy. I will speak fairly briefly, and then I will take your questions with assistance from my colleagues behind me.

Under current law CBO projects that the budget deficit this year, fiscal year 2010, will be about $1.35 trillion, or more than 9 percent of the country's total output. That deficit would be only slightly smaller than last year's deficit, which was the largest as a share of GDP since World War II.

We expect that revenues will grow modestly this year, primarily because we expect a slow pace of economic recovery. We expect that outlays will be about even with last year's level as a decline in Federal aid to the financial sector is offset by increases in spending from the stimulus program and for other purposes.

Debt held by the public will reach $8.8 trillion by the end of this fiscal year, or 60 percent of GDP, the largest burden of debt since the early 1950s.

Looking beyond this fiscal year, the budget outlook is daunting. Again, under current law, CBO projects that the deficit will drop to about 3 percent of GDP by 2013, but remain in that neighborhood through 2020. By that point interest payments alone would cost more than $700 billion per year. Moreover, maintaining the policies embodied in current law that underlie these projections will not be easy. It would mean, for example, allowing all of the tax cuts enacted in 2001 and 2003 to expire in 2011 as scheduled, and not extending the temporary changes that have kept the alternative minimum tax, or AMT, from affecting more taxpayers.

But many policymakers have expressed their intention not to let current law unfold as scheduled. If instead they extended all of the 2001 and 2003 tax cuts, indexed AMT for inflation, and made no other changes to revenue or spending, the deficit in 2020 would be twice the size of a deficit projection under current law. Debt held by the public would equal 87 percent of GDP and be rising rapidly.

The baseline projections also assume that annual appropriations will rise only with inflation. If instead policymakers increased such spending in line with GDP, which is about what actually happened during the past 20 years, the deficit in 2020 would be two-thirds again as large as projected under current law.

In sum, the outlook for the Federal budget is bleak. To be sure, forecasts of economic and budget outcomes are highly uncertain; actual deficits could be significantly smaller than we project or significantly larger. We believe that our projection balances those risks.

One set of factors contributing to the bleak budget outlook are the financial crisis and severe recession along with the policies implemented in response. Analysts define the end of a recession as the point at which output begins to expand again. By that definition the recession appears to have ended in mid-2009. However, payroll employment, which has fallen by more than 7 million since the beginning of the recession, has not yet begun to rise again. And the unemployment rate, as you know, finished last year at 10 percent, twice its level of 2 years earlier.

Unfortunately CBO expects that the pace of economic recovery will be slow in the next few years. Household spending will be restrained by weak income growth, lost wealth and constraints on their ability to borrow. Investment spending will be slowed by the large number of vacant homes and offices. In addition, although aggressive action by the Federal Reserve and the fiscal stimulus package helped moderate the severity of the recession and shorten its duration, the support to the economy from those sources is expected to wane. Employment will almost certainly increase this year, but it will take considerable time for everyone looking for work to find jobs. And we project that the unemployment rate will not return to its long-run sustainable level of 5 percent until 2014. Thus more of the pain of unemployment from this downturn lies ahead of us than behind us.

The deep recession and protracted recovery mean under current law, lower tax revenues and higher outlay for certain benefit programs. CBO estimates that those automatic stabilizers will increase the budget deficit by more than 2 percent of GDP in both 2010 and 2011. In addition, CBO projects that last year's fiscal stimulus package will increase the deficit by roughly 2 percent of GDP this year and by a smaller amount next year.

As the economy recovers and the effects of the automatic stabilizers and legislative policies fade away, the budget deficit will shrink relative to GDP. However, as I have noted, the projected deficit remains large throughout the decade even under current law, and if current law is changed in some way that more closely matches current policy as most people see it, the amount of government borrowing relative to GDP would be unprecedented in the post-World War II period.

A large and persistent imbalance between Federal spending and revenues is apparent in CBO's projections for the next 10 years and will be exacerbated in coming decades by the aging of the population and the rising costs of health care. That imbalance stems from policy choices made over many years. As a result of those choices, U.S. fiscal policy is on an unsustainable path to an extent that cannot be solved by minor tinkering. The country faces a fundamental disconnect between the services that people expect the government to provide, particularly in the form of benefits for older Americans, and the tax revenues that people are prepared to send to the government to finance those services. That fundamental disconnect will have to be addressed in some way if the Nation is to avoid serious long-term damage to the economy and to the wellbeing of the population.

The Chairman asked me to also specifically refer to some of the charts in the testimony that we submitted. Of course, we have written an outlook of almost 200 pages that I am sure you are taking home and poring over in your spare time, but we did have several charts in the testimony that I brought today that I think are worth attention.

If one looks at summary figure 1, if you have that in front of you, there is a picture of debt held by the public and net interest. It is a slightly complicated picture. The amounts are expressed as shares of GDP. The solid line is debt held by the public. The picture ranges from 2005 up through 2009, the left of that vertical line labeled "actual," and then the next 11 years of our projection. Debt held by the public, which was running about 40 percent of GDP before the financial crisis and recession, will jump from that 40 percent at the end of fiscal year 2008 to basically 60 percent at the end of this fiscal year, 2010. So in 2 years we will have increased the size of the debt relative to the economy by one-half. Under our projection it continues to rise a little further and is roughly stable around 65 percent, ending at 67 percent of GDP. Again, this is under current law, which assumes that tax cuts expire as scheduled, and that appropriations keep pace only with inflation.

The bars are net interest on the debt, again expressed as a share of GDP. That net interest actually was quite low last year despite the large debt because interest rates were quite low. But we and essentially all analysts expect interest rates to rise considerably as the economy recovers. And the combination of rising debt and rising interest rates will push debt payments up. In nominal dollars we expect them to triple over the next 10 years, as a share of GDP to roughly double.

The next picture we included in my testimony today is figure 2 which shows revenues and outlays of the government. This picture goes back 40 years into the past and then 10 years into the future with our projection. You can see that outlays have spiked up clearly in the last couple of years; are now at their highest level relative to GDP that we have seen; are projected to fall back, but to remain well above their long-run average, denoted by that horizontal dash line. Revenues have fallen very sharply, the lowest share of GDP seen in many decades, and are projected to rise again. Again, this is under current law, which assumes the expiration of the tax cuts. Under that current law revenues move up above their low historical level. However, if all of the tax provisions that are set to expire under current law were allowed to expire—that is 2001 and 2003 tax cuts, that is the extension of AMT, and also the extension of other expiring provisions—then our revenues would remain below their historical average throughout the 10-year projection period. It would be inching up close to it by the end of the 10 years.

And I think there is a third picture, which is the picture of the unemployment rate. You can see the very sharp rise. Of course, over the last several years you can see the decline. On this picture the decline looks fairly steep, the line comes down, but, of course, it is now so far above the long-run sustainable level that even at that pace of decline, it takes a number of years to come down. And you can see in that sense that more of the bulk of that peak actually lies in front of us than behind us, to the right side of that projected line. And that is the sense in which I think the pain of unemployment going ahead is likely to be greater, notwithstanding the fact that we and, again, I think essentially all other analysts, expect the GDP will continue to grow.

Thank you, Mr. Chairman. I am happy to take your questions.

Chairman SPRATT. Thank you very much, Mr. Elmendorf.

[The statement of Mr. Elmendorf follows:]

PREPARED STATEMENT OF DOUGLAS W. ELMENDORF, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Chairman Spratt, Congressman Ryan, and Members of the Committee, thank you for inviting me to testify on the Congressional Budget Office's (CBO's) most recent analysis of the outlook for the budget and the economy. My statement summarizes CBO's new economic forecast and baseline budget projections, which cover fiscal years 2010 through 2020. Those estimates were released yesterday in the report titled *The Budget and Economic Outlook: Fiscal Years 2010 to 2020.*

The Congressional Budget Office projects that if current laws and policies remained unchanged, the federal budget would show a deficit of about $1.3 trillion for fiscal year 2010 (see Table 1). At 9.2 percent of gross domestic product (GDP), that deficit would be slightly smaller than the shortfall of 9.9 percent of GDP ($1.4 trillion) posted in 2009. Last year's deficit was the largest as a share of GDP since the end of World War II, and the deficit expected for 2010 would be the second largest. Moreover, if legislation is enacted in the next several months that either boosts spending or reduces revenues, the 2010 deficit could equal or exceed last year's shortfall.

The large 2009 and 2010 deficits reflect a combination of factors: an imbalance between revenues and spending that predates the recession and turmoil in financial markets, sharply lower revenues and elevated spending associated with those economic conditions, and the costs of various federal policies implemented in response to those conditions.

The deep recession that began two years ago appears to have ended in mid-2009. Economic activity picked up during the second half of last year, with inflation-adjusted GDP and industrial production both showing gains. Still, GDP remains roughly 6½ percent below CBO's estimate of the output that could be produced if all labor and capital were fully employed (that difference is called the output gap), and the unemployment rate, at 10 percent, is twice what it was two years ago.

Economic growth in the next few years will probably be muted in the aftermath of the financial and economic turmoil. Experience in the United States and in other countries suggests that recovery from recessions triggered by financial crises and large declines in asset prices tends to be protracted. Also, although aggressive action on the part of the Federal Reserve and the fiscal stimulus package enacted in early 2009 helped moderate the severity of the recession and shorten its duration, the support coming from those sources is expected to wane. Furthermore, spending by households is likely to be constrained by slow growth of income, lost wealth, and limits on their ability to borrow, and investment spending will be slowed by the large number of vacant homes and offices.

Under current law, the federal fiscal outlook beyond this year is daunting: Projected deficits average about $600 billion per year over the 2011–2020 period. As a share of GDP, deficits drop markedly in the next few years but remain high—at 6.5 percent of GDP in 2011 and 4.1 percent in 2012, the first full fiscal year after certain tax provisions originally enacted in 2001, 2003, and 2009 are scheduled to expire. Thereafter, deficits are projected to range between 2.6 percent and 3.2 percent of GDP through 2020.

Those accumulating deficits will push federal debt held by the public to significantly higher levels. At the end of 2009, debt held by the public was $7.5 trillion, or 53 percent of GDP; by the end of 2020, debt is projected to climb to $15 trillion, or 67 percent of GDP. With such a large increase in debt, plus an expected increase in interest rates as the economic recovery strengthens, interest payments on the debt are poised to skyrocket. CBO projects that the government's annual spending on net interest will more than triple between 2010 and 2020 in nominal terms, from $207 billion to $723 billion, and will more than double as a share of GDP, from 1.4 percent to 3.2 percent (see Figure 1).

Moreover, CBO's baseline projections understate the budget deficits that would arise under many observers' interpretation of current policy, as opposed to current law. In particular, the projections assume that major provisions of the tax cuts enacted in 2001, 2003, and 2009 will expire as scheduled and that temporary changes that have kept the alternative minimum tax (AMT) from affecting many more taxpayers will not be extended. The

Table 1.

CBO's Baseline Budget Outlook

	Actual 2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total, 2011-2015	Total, 2011-2020
							In Billions of Dollars							
Total Revenues	2,105	2,175	2,670	2,964	3,218	3,465	3,625	3,814	3,996	4,170	4,352	4,563	15,941	36,836
Total Outlays	3,518	3,524	3,650	3,613	3,756	3,940	4,105	4,335	4,521	4,712	5,000	5,250	19,065	42,883
Total Deficit (-) or Surplus	**-1,414**	**-1,349**	**-980**	**-650**	**-539**	**-475**	**-480**	**-521**	**-525**	**-542**	**-649**	**-687**	**-3,124**	**-6,047**
On-budget	-1,551	-1,434	-1,076	-757	-659	-608	-619	-659	-659	-669	-765	-793	-3,719	-7,263
Off-budget[a]	137	86	96	108	120	133	139	138	134	127	116	107	595	1,216
Debt Held by the Public at the End of the Year	7,544	8,797	9,785	10,479	11,056	11,556	12,055	12,595	13,133	13,678	14,329	15,027	n.a.	n.a.
							As a Percentage of Gross Domestic Product							
Total Revenues	14.8	14.9	17.8	18.8	19.3	19.7	19.7	19.8	19.9	20.0	20.1	20.2	19.1	19.6
Total Outlays	24.7	24.1	24.3	23.0	22.5	22.4	22.3	22.6	22.6	22.6	23.1	23.3	22.9	22.8
Total Deficit	**-9.9**	**-9.2**	**-6.5**	**-4.1**	**-3.2**	**-2.7**	**-2.6**	**-2.7**	**-2.6**	**-2.6**	**-3.0**	**-3.0**	**-3.7**	**-3.2**
Debt Held by the Public at the End of the Year	53.0	60.3	65.3	66.6	66.3	65.6	65.4	65.5	65.5	65.7	66.1	66.7	n.a.	n.a.
Memorandum:														
Gross Domestic Product (Billions of dollars)	14,236	14,595	14,992	15,730	16,676	17,606	18,421	19,223	20,036	20,823	21,667	22,544	83,425	187,719

Source: Congressional Budget Office.

Note: n.a. = not applicable.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds and the net cash flow of the Postal Service.

baseline projections also assume that annual appropriations rise only with inflation, which would leave discretionary spending very low relative to GDP by historical standards. If the tax cuts were made permanent, the AMT was indexed for inflation, and annual appropriations kept pace with GDP, the deficit in 2020 would be nearly the same, historically large, share of GDP that it is today, and debt held by the public would equal nearly 100 percent of GDP.

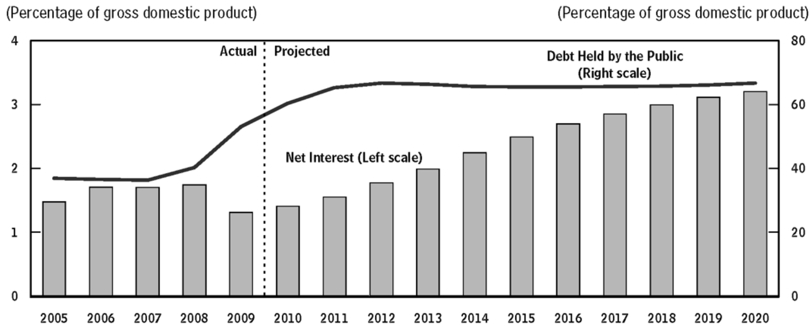
The Budget Outlook

In 2010, under an assumption that no legislative changes occur, CBO estimates that federal spending will total $3.5 trillion and revenues will total $2.2 trillion. The resulting deficit of about $1.3 trillion would be just $65 billion less than last year's shortfall and more than three times the size of the deficit recorded in 2008. Total outlays are projected to increase by just $5 billion, while revenues are projected to rise by $70 billion. The deficit for this year is on track to be about as large as last year's because an expected decline in federal aid to the financial sector will be offset by increases in other outlays, particularly spending from last year's stimulus legislation and outlays for income support programs, health care programs, Social Security, and net interest. At the same time, revenues are projected to increase only modestly primarily because of the slow pace of economic recovery forecast by CBO and the lagged effect of the recession on tax receipts.

In 2011, according to CBO's baseline projections, the deficit falls to $980 billion, or 6.5 percent of GDP, as the economy improves, certain tax provisions expire as scheduled, and spending related to the economic downturn abates. Revenues are projected to rise by about $500 billion, an increase of 23 percent, while outlays are projected to increase by $126 billion, or 4 percent.

Figure 1.

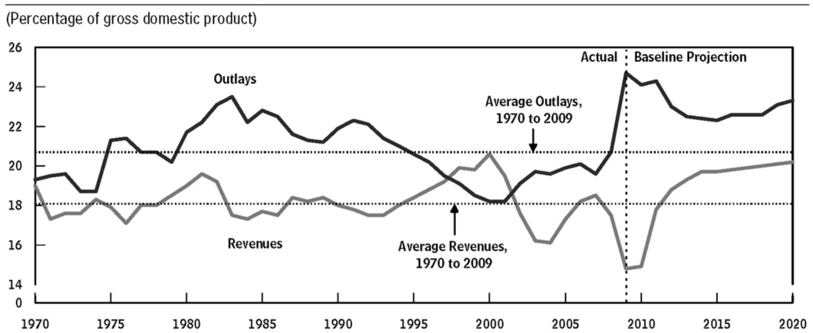
Debt Held by the Public and Net Interest



Source: Congressional Budget Office.

Figure 2.

Total Revenues and Outlays



Source: Congressional Budget Office.

Looking beyond 2011, CBO's baseline projections show outlays remaining between 22.3 percent and 23.3 percent of GDP (compared with 24.1 percent in 2010) (see Figure 2 on page 3). Continued economic growth will allow payments for unemployment compensation and other benefit programs to subside, and discretionary spending is assumed to increase slowly. However, the retirement of more members of the baby-boom generation and rising health care spending per person will cause outlays for Medicare, Medicaid, and Social Security to continue to grow fairly rapidly.

The baseline projections show revenues rising to 20.2 percent of GDP by 2020 (compared with 14.9 percent in 2010), with most of the increase stemming from individual income tax receipts. Almost half of the increase in those receipts relative to the size of the economy can be attributed to the expiration of provisions originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001, the Jobs and Growth Tax Relief Reconciliation Act of 2003, and the American Recovery and Reinvestment Act (ARRA), as well as other expiring tax provisions; the remainder is due to the economic recovery and structural features of the individual income tax system.

The Economic Outlook

Severe economic downturns often sow the seeds of robust recoveries. During a slump in economic activity, consumers defer purchases, especially for housing and durable goods, and businesses postpone capital spending and try to cut inventories. Once demand in the economy picks up, the disparity between the desired and actual stocks of capital assets and consumer durable goods widens quickly, and spending by consumers and businesses can accelerate rapidly. Although CBO expects that the current recovery will be spurred by that dynamic, in all likelihood, the recovery will also be dampened by a number of factors. Those factors include the continuing fragility of some financial markets and institutions; declining support from fiscal policy as the effects of ARRA wane and tax rates increase because of the scheduled expiration of key tax provisions; and slow wage and employment growth, as well as a large excess of vacant houses.

In CBO's forecast, real GDP increases by 2.1 percent between the fourth quarter of 2009 and the fourth quarter of 2010 and by 2.4 percent in 2011 (see Table 2). Given CBO's estimate of growth in potential output, those GDP growth rates will narrow the difference between actual output and potential output (the output gap) only slightly. Growth of real GDP will accelerate after 2011, spurred by stronger business investment and residential construction. For 2012 through 2014, CBO projects that real GDP will increase by an average of 4.4 percent per year, which would close the output gap completely by the end of 2014.

Even though economic activity began to increase again during the second half of 2009, the unemployment rate continued to rise, finishing the year at 10.0 percent. Hiring usually lags behind output during the initial stages of a recovery because firms tend to increase output first by boosting productivity and by raising the number of hours that existing employees work; adding employees tends to occur later. CBO expects that the unemployment rate will average slightly above 10 percent in the first half of 2010 and then turn downward in the second half of the year (see Figure 3). As the economy expands further, the rate of unemployment is projected to continue declining until, in 2016, it reaches 5 percent, which is equal to CBO's estimate of the rate of unemployment consistent with the usual rate of job turnover in U.S. labor markets.

Reflecting the large amount of slack in the economy, inflation will decrease further from its already low level in 2009, CBO forecasts. The core price index for personal consumption expenditures (that is, the PCE price index excluding the prices of food and energy) will rise by about 1 percent (on a fourth-quarter-to-fourth-quarter basis) in 2010 and by 0.9 percent in 2011. The overall PCE price index will rise by 1.4 percent in 2010 and 1.1 percent in 2011.

CBO's forecast anticipates slower growth in 2010 and 2011 than does the forecast of the *Blue Chip* consensus (reflecting the views of about 50 private-sector economists). Most private forecasters probably assume that the Congress will not allow previous tax cuts to expire as scheduled. If CBO assumed, in contrast with the assumption of its baseline, that all of the expiring tax provisions were extended beyond 2010, the agency's forecast of the level of real GDP at the end of 2011 would be in line with the forecast of the *Blue Chip* consensus (although real GDP in later years would be diminished relative to the baseline projection by the greater accumulation of government debt). CBO's forecast for inflation is roughly in line with that of the *Blue Chip* consensus in 2010 but significantly lower in 2011.

Table 2.

CBO's Economic Projections for Calendar Years 2009 to 2020

	Estimated	Forecast		Projected Annual Average	
	2009	2010	2011	2012–2014	2015–2020
	Fourth Quarter to Fourth Quarter (Percentage change)				
Real GDP	-0.4	2.1	2.4	4.4	2.4
GDP Price Index	0.9	1.0	0.9	1.2	1.7
PCE Price Index	1.4	1.4	1.1	1.2	1.8
Core PCE Price Index[a]	1.5	1.0	0.9	1.1	1.7
Consumer Price Index[b]	1.7	1.6	1.1	1.3	1.9
Core Consumer Price Index[a]	2.0	1.1	0.9	1.2	1.9
	Calendar Year Average				
Nominal GDP					
Billions of dollars	14,253	14,706	15,116	17,816 [c]	22,770 [d]
Percentage change	-1.3	3.2	2.8	5.6	4.2
Unemployment Rate (Percent)	9.3	10.1	9.5	6.5	5.0
Interest Rates (Percent)					
Three-Month Treasury bill rate	0.1	0.2	0.7	2.9	4.6
Ten-Year Treasury note rate	3.2	3.6	3.9	4.5	5.5

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: GDP = gross domestic product; PCE = personal consumption expenditure.

a. Excludes prices for food and energy.

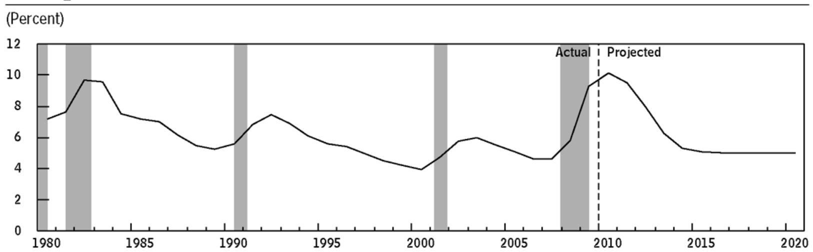
b. The consumer price index for all urban consumers.

c. Level in 2014.

d. Level in 2020.

Figure 3.

Unemployment Rate



Source: Congressional Budget Office.

Note: The shaded bars indicate the duration of recessions.

Chairman SPRATT. Last week in preparation for your testimony, we had a panel of four witnesses, all of whom warned of the deficit, and most of whom differentiated between the short-term cyclical debt and the long-term structural deficit. One who was particularly outspoken, as you might imagine, was Bob Greenstein, and he said, in effect, that the short-term deficits were a necessary encumbrance that had to be undertaken in order to respond to the cyclical downturn in the economy. These were necessary provisions for the most part, and the real concern had to be the long-term structural deficit as opposed to the short-term countercyclical measures we have taken.

Would you agree with that, generally speaking?

Mr. ELMENDORF. So as you know, Mr. Chairman, CBO does not recommend fiscal policies in the way that Bob Greenstein and others do, but I think it is a widely held view among analysts that the danger from the budget deficit arises from its persistent large size, not particularly from having a large deficit during this downturn.

I have said on a number of occasions that fiscal policy poses two central challenges to macroeconomic stability now, a short-run challenge and a long-run challenge. The short-run challenge is that fiscal stimulus will be withdrawn very rapidly over the next few years under current law. As the stimulus package effects wane, as tax rates increase under current law, as the automatic stabilizers diminish in importance, the deficit actually falls very sharply in the next few years, and that is a withdrawal of stimulus that private demand will have to overcome to continue to move the economy ahead.

The other challenge that fiscal policy poses to macroeconomic stability in the long run is the fact that fiscal stimulus doesn't really ever go away, that the budget remains very much out of balance for many years to come. How one resolves that tension is, of course, a matter for you and your colleagues. I think it is a widely held view that the principal damage from budget deficits comes from there being large periods when the economy is at full employment and when they really are crowding out investment in plant and equipment.

Chairman SPRATT. Let me go back to three points I made in my opening statement and ask you to comment on policies we have taken. A year ago, at the end of the fourth quarter of 2008, the economy was in deep recession, I think we would all agree. In that month alone the economy shrank by 5.4 percent beneath the previous quarter. By contrast, the economy in the third quarter of 2009 grew by 2.2 percent. Nothing to cheer over, but that is a movement in the right direction for sure, a swing of 7.6 percentage points, out of recession into growth in less than a year.

Secondly, a year ago, end of January 2009, the job market registered a loss of 741,000 jobs, and the previous quarter averaged a job loss of about 600,000.

Also, just for one indication of how all of this was impacting individual households, a year ago at the end of the fourth quarter, retirement accounts had lost $1.8 trillion, nearly $2 trillion over the previous year. Retirement accounts had fallen in value from $8 trillion in the first quarter to $6.2 trillion in the fourth quarter, a fall of $1.8 trillion in 1 year alone. By contrast, looking over the past year, 2009, retirement savings have risen from $5.9 trillion to $7.7 trillion at the end of the fourth quarter. All of those are dire developments that have turned into positive developments over the last year.

One factor in this turnaround surely, to what extent I know is debatable, one factor was the Recovery Act, $787 billion of countercyclical effort by the government. It is being shown and appears now on the bottom line of the budget because those outlays had to be made in the previous fiscal year and to some extent the current fiscal year.

You say, looking at the Recovery Act, and I am quoting from your testimony, it moderated the severity of the recession and shortened its duration. Can you quantify that? Can you tell us to what extent the Recovery Act stimulated this growth in GDP, in jobs in this recovery in the retirement phase?

Mr. ELMENDORF. Mr. Chairman, I am happy to offer our estimate of the effects. As you know, it is a difficult business to judge the effects of a particular piece of legislation or the entire Federal budget. Because of that, we have reported a range of estimates of effects. But we do believe, and have said this on a number of occasions, including today's testimony, that, as you said, the stimulus package did moderate the severity and shorten the duration of the downturn.

We estimate that the legislation raised real GDP by 1.3 percent to 3.5 percent, somewhere within that 1.3 to 3.5 percent range, during the second half of 2009 relative to what it would have been without the stimulus. I think the last estimate that we provided of the employment effects was in a report that we issued that was required by law in November, and this was based on the effects through the third quarter. Our estimate through the third quarter was that employment was boosted by between 600,000 and 1.6 million jobs.

Chairman SPRATT. So the Recovery Act has had a positive impact?

Mr. ELMENDORF. That is our judgment, yes, Mr. Chairman.

Chairman SPRATT. You also warn in your testimony that the recession probably ended in the middle of last year, the last calendar year, but you warn that it is likely to be a slow slog from here to full employment. In fact, I think the date you targeted for full employment is 2014, some time away. Would you comment on why that is?

Mr. ELMENDORF. I think there are several factors. One is that we expect overall economic growth to be only moderate in the next few years. In the wake of some past deep recessions, the Federal Reserve has cut interest rates sharply, and there has been pent-up demand for housing, and for other consumer durable goods, and for business investment that has propelled the economy on a fast upward trajectory. Given the nature of this particular downturn, and something in common with some past downturns due to financial crises in our country and others, is that that pent-up demand is not there in the same way. We have more houses than there is current demand for. So we think that the economy is likely to grow more slowly, and one direct effect of that is smaller increases in employment.

A second factor is that hours worked for people who have jobs has been on the downward trend for decades, but it declined fairly sharply in this recession. And thus we think as firms need more labor to produce product as demand starts to rise, the first thing they will do is to start to increase the hours of people who are already employed rather than to employ new people. That will come later.

A third factor is that recessions often accelerate restructuring under way in the economy that pushes companies that were struggling over the brink, and pushes companies that were doing well perhaps into a dangerous territory. And one way that our economy tends to grow and to create jobs is that people move, they move to other parts of the country. That kind of regional migration has been an important feature in the past, but we think will be harder to accomplish in this recovery because of the problems in the housing sector. A minority, although a significant minority, of people are under water in their homes, owing more in mortgages than the houses are currently worth. We think they will have difficulty going to other locations where jobs are more available. I think that will hamper growth a little bit.

But the biggest factor, again, is the first one, which is just that with slow economic growth, we think there will be slow growth in employment, and that is a pattern that has been consistent in the past. We mentioned in our report the past four recessions. Those with fast GDP growth have had fast employment growth; those with slow GDP growth had slow employment growth.

Chairman SPRATT. Despite the growth in the debt, we have not had what you would normally expect in the way of an increase in debt service, not yet, because of the historically low rate of interest that the national debt bears today. But as that rate rises with the resurgence of the economy, the cost of debt service will go up, and you have got a frightening number, frankly, in your testimony, namely that last year we spent $207 billion for debt service. By 2020, that will be $723 billion. And that, too, is an entitlement.

We tend to think about Social Security and Medicare and Medicaid as being the entitlements of great concern to us. Interest on the national debt is truly obligatory; it has to be paid. It is an entitlement in the strongest sense of the word.

Our witnesses last week suggested that we need some targets. We don't need to be out there doing ad hoc things. At least for the intermediate and the long run, we need some target to shoot at, and they were suggesting that we should try to bring the deficit down to 3 percent of GDP and bring the debt or at least hold the debt to no more than 60 percent of GDP. Are those reasonable goals? Do you think they are too liberal, too high, too tight, too strict?

Mr. ELMENDORF. So again, Mr. Chairman, it is not our place at CBO to suggest what your goals should be. Economists don't have any analytic basis for saying this is the crucial point in terms of debt or deficits. It is true that as we push in this country to 60 percent of GDP at the end of this year and beyond, that over the next few years we are moving into territory that most developed countries stay out of. We are moving into territory that is unusual in our historical experience and in the experience of other countries that we think of with solid economic situations. That raises the risk every step that we go. But what precise point you should stop at is not something that has an analytic basis for answering.

It is true that the numbers that you suggest have been discussed fairly widely. I think one thing to note is that our baseline projection is for deficits about 3 percent of GDP. And the interest payments that you point to are assuming that we have deficits of about 3 percent of GDP, not in the next couple of years, but beyond that, for the rest of the 10-year period.

Chairman SPRATT. But your baseline is not the worst-case scenario by any means.

Mr. ELMENDORF. No. And the challenge there is, again as I have said in my opening remarks, that many Members have discussed making changes that would increase deficits relative to our baseline, and in particular extending the expiring tax provisions and indexing the alternative minimum tax. So in some ways relative to what many people would think of as current policy—the policies we have in place, the tax rates we have now—the deficit would be much larger than our official baseline. And to get to 3 percent from there would require a good deal of policy change.

Chairman SPRATT. Mr. Director, thank you very much for your testimony and for the good work CBO does for us continually.

Mr. ELMENDORF. Thank you.

Chairman SPRATT. Mr. Ryan.

Mr. RYAN. The health care bill is very complex, has a lot of moving parts. You and your staff have done a very good job of working overtime to give us estimates. But you are currently scoring the bill on last year's baseline, and we now have a new baseline. So I think it is just for the sake of accuracy, so we know what we are doing, to have this scored on this year's baseline. So I would like to request that you score the health care bill on this year's baseline. When do you think you could produce a score so that we know what it will cost using the current baseline?

Mr. ELMENDORF. That is a quite reasonable request, Congressman. I don't think I have a very good answer. CBO's traditional practice across a range of pieces of legislation is to continue, when legislation is in process, to continue scoring it on the baseline with which we started that process.

In particular, Congress adopted a budget resolution last spring based on our March 2009 baseline projections. We have used that for scoring legislation since then, even though we updated our outlook for the economy and the budget last August. And we as a general matter continue to estimate based on that baseline until there is a new budget resolution.

Now, it is also true that we, in response to a request like yours, try to provide a parallel estimate, if you would, based on a more recent baseline. And we do that particularly when we have a reason to believe that the change in the baseline is consequential for the estimate and that an estimate based on the earlier baseline might be misleading in some way. We have not actually updated the details of the health baseline. So there is baseline forecasts that we released, of course, but the details that we need for the recalibration of our models to do estimates off this new baseline is a project itself of several weeks' duration that we have not had time to undertake. Maybe after doing that we can then proceed to try to estimate some particular bill, and I am not sure at that point which health bill you and others would find most interesting.

Mr. RYAN. I am not sure exactly what the time line is of the health bill. I don't even know if the Majority knows what the time line is. But you just rescored the stimulus, which is enacted law, I understand, but that went up to $862 billion. So you are telling us several weeks, meaning we probably won't see a score using the new baseline until after this is done, if this is done within less than several weeks?

Mr. ELMENDORF. So that is right. Again, it takes us several weeks to recalibrate the models. And these are the same people, I am afraid, who will also be estimating the President's budget.

Mr. RYAN. I understand. Let me—we have got a lot coming down the pike. Let me ask you this. It is CBO's normal practice to provide estimates of authorization of appropriations. You haven't been able to provide those yet. I think Mr. Lewis, the Ranking Member of the Appropriations Committee, has requested this information particularly in view of a freeze. When are we going to get the estimates of the appropriations authorizing required in the health care bill? That, I think, is probably easier to achieve before we vote on this. What are the appropriations we are talking about here? Can you get that estimate?

Mr. ELMENDORF. So we have received that request, and we talked with the Ranking Member's staff. In our estimate of the health bills we have included a section that offers a range of what we believe to be the appropriations necessary to finance particular parts of the government that would be responsible for running the insurance exchanges or making changes in Medicare and so on. Those ranges are in several categories, ranges of $5 billion to $10 billion in several of these categories.

To do a complete estimate of the appropriations that might be required would be—it doesn't require doing your baseline, so it avoids that complexity, but is itself very complicated. There are a lot of provisions, as you know, a couple of thousand pages of legislation, so that would also take us several weeks. It is a completely legitimate question, and we would like to provide an answer.

Mr. RYAN. This is a creation of a new—we haven't created a program like this in a generation. And so it would, I think, be helpful if we know just the cost of all the government that is being created here. And of all the things that I think would be easier to do is just the discretionary spending; how many new people do we have to hire, how many new agencies, what is all this new government, which is the biggest in a generation, going to cost? That estimate I would like to think you could probably get hopefully before we vote on it.

Chairman SPRATT. Will the gentleman yield?

Mr. RYAN. Sure.

Chairman SPRATT. Now, there is a question about whether or not in parts B and C, in particular the House bill, there is a lot of money that is authorized but not appropriated, is subject to appropriation. So it is not an indication of what is going to be spent, it is an indication of ideally what we would spend to serve a particular purpose if the funds were available. But we don't want to confuse the number with the insurance underwriting provisions, which are more or less an entitlement.

Mr. ELMENDORF. Yes, Mr. Chairman.

I was going to say, Congressman, that we tried in our letter to, again, use ranges, not very precise, but ranges of the parts that would be critical to implementing the legislation, the things without which the mandatory spending could not sensibly occur. We have not done the other things that really are subject to future appropriation decisions.

Mr. RYAN. Right.

I want to be mindful of the time. So we are at 60 percent of GDP now. We are heading north. If you use the alternate fiscal scenario, I think we are at 85 percent by the end of the window, which I think is a more realistic measurement of what is going to happen. We get about half our debt from foreigners. Is there a tipping point, in your mind, using your background academically, whereby foreign investors start losing confidence in our ability to turn this thing around? I mean, Greece is having a problem floating their bonds because of their debt-to-GDP ratios. Where, in your mind, do we start hitting that nexus, that tipping point? And then just one quick final question I will have for you.

Mr. ELMENDORF. So, I don't know. I mean, of all the things economists have trouble predicting, which is almost everything, swings in investor confidence must be pretty high on that list. So it is true we sell almost half; almost half of our debt is held now overseas. That is a large increase from a decade ago. We have benefited during this financial crisis for all the problems here in this country by investors here and around the world thinking of U.S. Treasury securities as still the safest investment.

Mr. RYAN. But we were like in the high thirties at the time on our projected GDP ratio?

Mr. ELMENDORF. That is right, absolutely. So at the moment during that crisis, money came in, interest rates have been quite low, as we said. Widespread view among analysts is that is ending now; that as investors become more willing to take risks again in other investments, and as they focus more on the trajectory of U.S. fiscal policy, that there will be much less willingness to buy Treasury securities at current low interest rates. But so I think analysts widely agree there is an increasing risk over time of some flight from Treasury securities or flight from dollar assets. But how large that risk is, or what would trigger it, or when it would be triggered is just beyond our capacity.

Mr. RYAN. I think the operative word is "trajectory." If the trajectory shows that we don't have our fiscal situation under control, it gets much worse, investors flee. If we get this under control by actually reforming government entitlements, the budget, then the trajectory over the long run is going in the right direction, and that would restore confidence. I think that that kind of answers itself.

Okay. One last thing. Lots of economists are telling us 2011 is going to be a slowdown year. I see that in a lot of blue chip and a lot of private forecasts. I notice that you have it in yours as well with this new baseline that you are saying we are going to have a 2.2 percent growth this year, and then it is going to slow down next year. Why is that, and to what extent is the expiration of the 2001 and 2003 tax cuts which occur in 2011 a contributing factor to the slowdown in our economy that you are projecting for 2011?

Mr. ELMENDORF. The numbers I focused on most are our fourth-quarter-to-fourth-quarter changes. On that basis we expect real GDP to grow 2.1 percent this year and 2.4 percent next year. Some pickup, but less than would be the case—you may be looking at a year-over-year average?

Mr. RYAN. Yes. 2.2 to 1.9.

Mr. ELMENDORF. Right. So it depends whether you are looking at the average for a year relative to the other year or quarter-end-to-quarter-end. The reason I prefer this is because the tax cuts will expire on a calendar date, and we think that will then depress economic growth in the first part of 2011 relative to what would otherwise occur.

Mr. RYAN. How much do you shave off of growth because of the expiring tax cuts?

Mr. ELMENDORF. So, in a very rough sense, if we were to take those expirations out of our projection, we would raise GDP growth over the next couple of years from here, say, to the end of 2011 by about 1½ percent cumulatively.

Mr. RYAN. One and a half percent?

Mr. ELMENDORF. Cumulatively. That is if the tax cuts were extended on a permanent basis. We have done a different sort of calculation in the paper we released a week or two ago about policies to create employment and jobs. We looked at a set of temporary policies including a temporary extension of those tax provisions. A temporary extension has less stimulus effect on growth.

Mr. RYAN. Right. Permanent income effect applies if it is permanently extended.

Mr. ELMENDORF. Now, these are effects for 2010 and 2011 we are talking about, of course. Over a longer term the extra borrowing of several trillion dollars over the next decade that would ensue from that change in policy would crowd out investment and would tend to damp growth over the back half of the 10-year window and beyond.

Mr. RYAN. I have got some technical questions I want to ask you about the freeze proposal, questions dealing with unobligated balances and things like that. Can I, just in the interest of time, give you some stuff in writing that you can work back with us?

Mr. ELMENDORF. Even better. Great. Thank you, Congressman.

Mr. RYAN. Thank you. I yield.

Chairman SPRATT. Ms. Schwartz.

Ms. SCHWARTZ. Thank you, Mr. Chairman, and thank you for the hearing. And I was going to say welcome to Dr. Elmendorf, but—and you are welcome—but it is, I think, both good news and bad news. I appreciate your comments on where we stand right now and some of the actions that we have taken in the last year that have helped stabilize the financial situation and is beginning to turn the economy around. That is good news to the American people, although, as all of us know, that until we start to see new jobs, expansion of the economy here at home, they are really just numbers to people. But we can be more hopeful that we are beginning to regrow this economy, and that is good news.

But it is daunting, the numbers that you present, in terms of the deficit. Again, I think some of this is good news on our part because we are taking it seriously. And I want to just ask a couple questions about, one, how we got here. I think that we don't want to go over a lot of history, but I think it does help for us to understand what we inherited and the situation and how we got here. And we know that President Obama inherited a $1.3 trillion deficit for this year. It is just about that now even with the additional Recovery Act, the additional $700 billion to $800 billion. That is good news, right? That it is stable at least, it didn't go up, but there was some anticipation that it was going to go up?

Mr. ELMENDORF. I guess so, Congresswoman.

Ms. SCHWARTZ. Again, I am not looking to paint a rosy picture here. I want to say we are trying to keep things somewhat stable. But you have mentioned that the revenues were down. When you say that, it makes it sound like "How did that happen?" That we didn't know that? We actually know why revenues were down in the last 8 to 10 years. It is because there were dramatic tax cuts, particularly for wealthiest Americans; is that right?

Mr. ELMENDORF. There certainly were very substantial tax cuts, a good share of which were received by higher-income Americans, and that is a feature that is holding down revenues relative to what they would have been otherwise, absolutely.

Ms. SCHWARTZ. And if we do maintain the tax cuts for Americans below a $200,000 family income, but not for the wealthiest Americans, would that help to be able to bring some more revenue into the government over the next number of years?

Mr. ELMENDORF. Again, our current law baseline lets all the tax expire. Extending all of them costs much more, makes the deficit much worse, as I said. Extending only some of them will have a partial effect. I think the lion's share of the money from extending those expiring tax provisions would go to people below the income thresholds that you suggest, although certainly a significant amount would go to people above those thresholds.

Ms. SCHWARTZ. Well, we obviously are looking at that.

The other piece of what got us here is the biggest extension under Medicare since its beginnings: Part D, the prescription drug benefit. I wasn't here at the time, but certainly I think as Democrats we believe that we should extend prescription drug benefits to seniors, but we also believe it should have been paid for, and we believe now it should be paid for.

So the notion of how we budget this new health care bill is really very important going forward. I appreciate your comments about how we are—you have to look very, very clearly about what the cost is to the health care bill. But in the analysis that you have already done in both the House bill and the Senate bill, and, again, you can't predict which one we will—and exactly what it is going to look like—but in both cases you anticipated a reduction in the deficit if we enact comprehensive health care reform. And it may not be going as far as you might like or might expect that we can do in dealing with—and again, you don't create policy, I understand, in terms of bringing down the deficit, but it actually is a very clear reduction of over $100 billion in your estimates. So would you say that enacting health care reform would have a positive effect on the deficit?

Mr. ELMENDORF. Yes, Congresswoman. We estimated that both the bill to pass the House and the bill to pass the Senate would reduce budget deficits over the next 10 years by $130 some billion if they unfolded as written, and would reduce budget deficits in the subsequent decade, again, if they unfold as written. These reductions are, as you say, in the direction of reducing deficits. They are, as you understand, a small step in that direction.

Ms. SCHWARTZ. I think that appropriately you are very conservative in the way you anticipate savings, and that is a good thing. We don't want to overanticipate savings. But there are some of us who feel if done well and done right, we will actually see potentially more savings. Which could be very helpful.

I will just end by saying we are taking very seriously the issue of the deficit. By creating a Commission—if it is not done statutorily will be done by Executive Order—to focus on the debt and the deficit, and on all aspects of the budget as both spending and tax revenue is all really very important, as well as through PAYGO, which we have pushed actively in the House. Could you comment on how important it is for us to take it seriously by enacting both PAYGO in the Senate and House, and the Commission?

Mr. ELMENDORF. So I think analysts believe, including those at CBO, that the PAYGO rules and discretionary spending caps in the 1990s did help to restrain policy actions that might otherwise have worsened the budget deficit. And they did so particularly during the period when attention of policymakers in both parties was focused on a deficit problem. At the end of the decade, as the deficit problem was temporarily going away, then those restraints were widely ignored, but during the period when attention was focused on that problem, those restraints helped.

Of course, all those constraints can do is to prevent or discourage policy actions that would make the deficit worse; they don't create actions to make the deficit better. Those sorts of actions require difficult decisions, and a Commission doesn't eliminate the need for those difficult decisions. It may provide a mechanism for encouraging those decisions to be made. We don't have a lot of evidence about that, and, as you say, CBO doesn't have a position on whether that should be pursued or not.

Ms. SCHWARTZ. We are taking it seriously. Thank you.

Mr. ELMENDORF. Thank you, Congresswoman.

Chairman SPRATT. Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman.

First, with all due respect to our Vice Chairman, I am finding it challenging to find any context by which I can call a $1.3 trillion deficit good news. Having said that, Dr. Elmendorf, I thought I awoke to good news yesterday when I read the Washington Post: Obama to Propose Freeze on Spending; New York Times: Obama to Seek Spending Freeze to Trim Deficits. Frankly, I was overwhelmed by the headlines, and then I read the article, and I became underwhelmed.

First, do you have an understanding or have you studied the President's proposal?

Mr. ELMENDORF. I only know what I read in the newspapers, Congressman. As you know, the President will release the budget next week, and then we will complete and report our analysis of it.

Mr. HENSARLING. Dr. Elmendorf, let us see if we are reading the same newspapers. The newspapers I read say that the President's proposal will exempt 83 percent of the budget. Do the newspapers you read say the same thing?

Mr. ELMENDORF. So I didn't take notes, Congressman. I am loath to do instant analysis of things that you are telling me I should remember from yesterday's reading of the newspaper. What is true is that, as you know, most spending in the government is now in these mandatory programs, discretionary spending is smaller, and when one exempts the defense- and security-related pieces, one is down to less, much less, than half.

Mr. HENSARLING. When you actually have the details of the proposal, I would appreciate your analysis.

You may or may not recall this from the articles. I understand that this is not an immediate freeze, something that could take place today, a rescision could take place today, but it is a freeze promised to take place in the future for fiscal year 2011. Is that your understanding from your reading of the proposal?

Mr. ELMENDORF. Yes, that is my understanding.

Mr. HENSARLING. Dr. Elmendorf, obviously we don't have the President's budget proposal, but we have his 10-year budget proposal from last year. So I am trying to figure out what does it mean, as I understand it, to apply a 3-year freeze to 17 percent of the budget? First, as I understand it, this is on top of two omnibus appropriations bills that increase nondefense discretionary 10.3 in fiscal year 2009, 12.3 in fiscal year 2010. We already know about the $1.2 trillion stimulus plan that still has us mired in double-digit unemployment.

So if you will indulge me, but just a little back-of-the-envelope calculation, isn't the President in some way saying after increasing spending 10 percent one year, 12 percent the next year, I am going to freeze it for the next 3 over a 5-year budget window? So isn't he really saying, my idea of fiscal responsibility is I am going to propose 5 percent spending growth a year in these accounts when I actually wanted to spend double-digit? Is that a fair assessment?

Mr. ELMENDORF. Congressman, I can't speak to the details of the proposal until we have numbers to analyze. Your 83 and 17 may well be right, but we can't do that calculation until we see the details.

Mr. HENSARLING. Well, let me try another set of numbers on you. Again, we have the President's 10-year spending plan that he submitted last year. It starts out at almost $3.6 trillion in fiscal year 2010. It ends up in 2019 at $5.2 trillion. Now, as I understand the plan, he is proposing a $250 billion savings, according to what I understand from the White House. I assume, don't know, that the President will submit another 10-year budget plan.

If you take $250 billion savings over a 10-year period, again, this is using his last year's budget, don't know what is this year's budget, but if we applied his proposed so-called freeze to his last year's budget, what it appears to me is it is a proposal to raise Federal spending 44.3 percent as opposed to 45 percent. Again, we don't have his numbers, but do you at least recall that the spending trajectory was proposed to go from $3.6 trillion to $5.2 trillion?

Mr. ELMENDORF. I don't remember the specifics of that calculation, but your point is that their $250 billion estimate is certainly a small share of the deficits that we project under the baseline, which are a good deal smaller than the deficits that we projected for the President's budget last year.

Mr. HENSARLING. Would that qualify, as you said, I believe, in your testimony, quote/unquote, minor tinkering.

Mr. ELMENDORF. I think it is a small step, and I doubt there is a single step that can accomplish the extent of deficit reduction that many people have in mind.

Mr. HENSARLING. Well, I see my time is running by. I certainly have high hopes for tonight, but I fear the President's plan is a lot more about trying to impact newspaper headlines and not budget baselines.

I yield back the balance of my time.

Mr. ELMENDORF. Can I emphasize, Congressman, also we will certainly report back to you fully on our analysis of the President's budget when we have the details that we need to do that.

Chairman SPRATT. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman.

And thank you, Dr. Elmendorf.

Just to be clear on this last line of questioning, during the 8 years that the Republicans were in power, did they enact a freeze on any kind of spending in any one of the 8 years?

Mr. ELMENDORF. Not that I am aware of, Congressman.

Mr. DOGGETT. Not that I am aware of either.

But I think it is appropriate that they scrutinize the President's recommendation, but it needs to be scrutinized against real world history.

One of my concerns is that, as Congress moves forward to try to encourage job growth, that we may have the effect of producing few jobs and great deficits, and I think that is a potential problem with some of the ideas that have been advanced by Democrats and certainly the principal idea advanced by Republicans to encourage job growth.

You pointed out, I believe, that while spending was high relative to gross domestic product, that we have the lowest revenues, I believe you said, as a percentage of output that we have had coming into the Federal Government in decades?

Mr. ELMENDORF. Yes.

Mr. DOGGETT. And I think the problem is that, most of the questions you have received this morning, Doctor, only address half of the budget. They focus on the direct spending, but they ignore the growth in tax expenditures, the use of the Tax Code sometimes to advance policies that may be very similar to the objectives, some worthy, some not so worthy, that occur through direct spending.

In terms of our long-term national debt and all of the negative aspects associated with it with foreign borrowers and reduced standard of living, in terms of the national debt alone, it doesn't really make any difference whether the debt is affected by tax expenditures or direct expenditures. They have the same effect on the debt, do they not?

Mr. ELMENDORF. Yes, that is correct, Congressman.

Mr. DOGGETT. And as we look at some of the ideas that were considered last year, let me go to the Democrats first. You have provided us an excellent analysis this month in the policies for increasing economic growth that CBO put out. One of the politically popular ideas was what is called bonus depreciation. And I believe your analysis is that if we use the Tax Code to do that, that for every dollar that we drain from the Treasury, we will get back 20 cents to up to maybe the dollar itself. Is that right?

Mr. ELMENDORF. Yes, Congressman, I think that is correct.

Mr. DOGGETT. So it is not really necessarily the best bang for the buck to go that approach, even though it may be politically popular.

And then last year when we considered the stimulus, one of the popular ideas then was what is called loss carried back. And your testimony last January was that the effect of this provision on business spending would probably be small. We limited it then to small businesses, but then the only way, apparently, we could get enacted an extension of unemployment and COBRA benefits in December was to tell the Treasury to write checks for $33 billion this year to businesses in what is called loss carried back. And one of those was a bond insurer that made bad bets on subprime mortgages, and it got about a billion by itself.

Let me just ask you, for businesses of various types that got those, but since a defunct business that didn't have a single employee could get loss carried back and get a check written by the Treasury, if the Treasury writes a check to a company that has no employees, does that contribute any more than zero to growth and output?

Mr. ELMENDORF. It doesn't contribute very much, Congressman.

I mean, I think there is a longstanding view in the economics profession of encouraging the tax changes for businesses that encourage types of behavior to be much more effective than simply changing cash flow.

Mr. DOGGETT. Let me move in my final seconds here to the principal Republican idea, which is that the solution to all of our problems is to extend the Bush tax cuts, which added so much to our moving from surplus to debt shortly after the Bush administration took over.

In the final two pages of your report, you indicate that extending for 1 year, all of the Bush tax cuts and the AMT patch for 2 years, that that will get us in output about 10 cents to 40 cents for every dollar that it costs the Treasury; isn't that right, on page 25?

Mr. ELMENDORF. Yes, that is right, Congressman.

Mr. DOGGETT. And then if we did—since the Republicans don't want to do that; they want to do it permanently. The final sentence of your report is that if there were a permanent extension of all of those tax cuts, we would get much less than the 10 to 40 cents per dollar we would get for doing it for 1 year; is that right?

Mr. ELMENDORF. Yes, that is right, Congressman.

Mr. DOGGETT. And that would cost us to do that about another $5 trillion, wouldn't it?

Mr. ELMENDORF. I think $4.5 trillion is the number I have in my head, yes, Congressman.

Mr. DOGGETT. Thank you so much.

Chairman SPRATT. Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman.

And thank you, Dr. Elmendorf, for your, I think, accurate and rational yet sobering report. In the report, you use the term "unsustainable," a term which a number of people use in terms of the current budget deficit track and a term I have used myself. And I assume that is in reference to the CBO baseline, which we admit, the chairman admitted, is actually, taking into account political realities, probably one of the more optimistic scenarios for the budget deficit going forward.

I am not sure that there is a complete understanding of the consequences of inaction here in this town. We use the term unsustainable. Can you be a little more specific and describe to us what happens? We do nothing. We now look at deficits of $500 billion to a $1.5 trillion as far as the eye can see. What happens?

Mr. ELMENDORF. I think the particular thing that is unsustainable is to have Federal debt constantly rising as a share of GDP, because that requires an ever larger share of investors' portfolios to be occupied by Treasury securities, and at some point, they will refuse to hold them or will insist on much higher interest rates to do so.

The thing that is particularly unsustainable is expecting that investors will just constantly pile more and more of their portfolios, investors here and abroad, into Treasury securities. What can go wrong is that interest rates can spike up when there is a crisis of confidence and their sentiment about buying those securities changes.

But even before you hit the crisis point, of course, what is going wrong in a more subtle, less obvious, but still very damaging way is that the more of those Treasury securities that are being held, the less investors will be holding of shares, the ownership of physical plant and equipment, the sorts of things that make workers more productive over time and raises incomes over time.

Mr. CAMPBELL. What does that mean? Does that mean, then, we have much lower GDP growth? Does that mean the Federal Government's debt rating gets reduced and we are actually perhaps physically unable to sell the debt at some point? What are the——

Mr. ELMENDORF. That is all possible. I think most observers expect that the government will act, that the unsustainability will be resolved through action, not through witnessing some collapse down the road. If literally nothing is done, then eventually something very, very bad happens. But I think the widespread view is that you and your colleagues will take action.

Mr. CAMPBELL. And I think—I wish it were not true, but I sense that that won't happen until people fully understand that very, very bad thing and how very, very bad it is.

Mr. ELMENDORF. Again, it is not something——

Mr. CAMPBELL. I know you don't like to alarm people, but I think, frankly, we have to alarm people.

Mr. ELMENDORF. I think we have given an accurate, as you say, sobering view. Again, we are not trying to overly dramatize. We are not trying to sugarcoat. We are presenting the facts for you and for the American people. And then it is up to you all to make whatever decisions you choose to make.

Mr. CAMPBELL. A couple of more questions if I can in the time that I have got. If you said that, all right, we are going to let spending grow with GDP, stay where it is with GDP and we are going to balance this budget on tax increases entirely, do you have any sense—and throw the health care bill in there as a tax increase as well—do you have any sense for what kind of tax increases that would require?

Mr. ELMENDORF. Well, I can give you one illustrative case. If you look at the budget in 2020, if your goal were to balance the budget in 2020, our baseline projection is a deficit of about $700 billion. If you extended the 2001 and 2003 tax cuts and index the AMT, the deficit would be about twice that size, as I said, $1.4 trillion. So, by comparison, individual income tax revenues in our baseline, even before you take account of the fact of this extra cut, are $2 ½ trillion. So if we want to narrow a gap of $1.4 trillion by increasing a category whose baseline size is $2.4 trillion, that requires a very substantial increase. So it is very difficult, given those numbers.

But can I say also, that number is quite large, doing all of those changes on the spending side to be equivalently radical changes in the spending categories.

Mr. CAMPBELL. I understand that. But I think the point is that if you keep spending where it is as a percent of GDP—forget the health care bill, from that increasing it. Potentially it is a 50 percent, 60 percent increase in every single Federal tax on every single human being in this country.

Mr. ELMENDORF. It would take—I haven't done the percentage calculation. We have done them on some occasions in the past in requests, but it would take a very substantial increase in tax rates no doubt.

Mr. CAMPBELL. Thank you, Mr. Chairman.

Chairman SPRATT. Mr. McGovern.

Mr. MCGOVERN. Thank you, Mr. Chairman.

And thank you, Dr. Elmendorf. This is a very important hearing.

If I could follow up on the remarks of Ms. Schwartz and Mr. Doggett, I think it is important that we all understand how we got in this mess to begin with. And when I hear my Republican friends talk about the importance of trying to rein in spending, I would just remind them that, under the Clinton administration, total spending grew at an average annual rate of 3.5 percent. Under the Bush administration, total spending grew at an average annual rate of 8.4 percent. The fact is that President Obama inherited a mess of an economy as a result of what I believe are fiscally irresponsible policies of the previous administration.

And there is no question that we need to take some strong and bold action. I will say, also, that for all the whining about the Reinvestment and Recovery Act, I can tell you, from my experience in Massachusetts, that teachers' jobs have been saved. Police officers' jobs have been saved. Firefighters' jobs have been saved. Jobs have been created in the construction industry and in some of the high tech industries. So we have seen the benefit.

Has it created as many jobs as I would have liked to have seen? No. But without it, I think we would be in a much bigger mess than we are in right now. So I find it ironic that the same people who drove this economy into a ditch are now complaining about the size of the tow truck. The fact of the matter is, we are in a mess, and some tough measures have to be taken.

I want to praise the President for his announcement in the newspaper, trying to figure out a way to deal with the deficit and with the debt so it is not thrust on the backs of our kids and our grandkids. But one of the things I worry about is not what we are spending on defense, but specifically war costs.

I mean, we have been fighting wars since 2001. And they have been expensive. And we have been paying for these wars or funding these wars through emergency supplemental appropriations where there are no offsets. I mean, hundreds of billions of dollars have been spent but not offset. And no matter what you think about the war in Afghanistan, I think the President is making a mistake by trying to increase troops in Afghanistan. But we are told now we are going to have another emergency supplemental, another $33 billion or $35 billion, and it goes on and on and on. And I think this notion of paying for wars with emergency supplementals and not offsetting I think is the wrong way to do it. But I think it has a devastating impact on our deficits and our debt. I appreciate your comments on that subject. I am afraid these wars are going to bankrupt us. And I would appreciate anything you have to add to that.

Mr. ELMENDORF. On the point you made earlier about the stimulus package, Congressman, we agree that, relative to what would have occurred without that package, there is more GDP and employment.

Mr. MCGOVERN. Which is a good thing.

Mr. ELMENDORF. I think I am allowed to say I think that is a good thing. Yes, sir.

Mr. MCGOVERN. Thank you.

Mr. ELMENDORF. On the cost of the wars, again, it is a policy choice. To date, Congress has appropriated about $1.1 trillion for fighting in Afghanistan and Iraq and related activities.

Mr. MCGOVERN. Do you know how much of that was offset? How much did we pay for, or is that all on our credit card?

Mr. ELMENDORF. Well, there is no specific linkage of particular spending decisions to particular revenue-raising decisions. It is certainly true that the deficits over that period have well exceeded $1.1 trillion.

Mr. MCGOVERN. I guess my point is that, if you are going to fight these wars, you ought to pay for them, because there are impacts—it impacts very negatively on our deficits and on our debts. And this notion that we can fight these wars and not even have to talk about how we pay for them I think is a bad way to do business.

Mr. ELMENDORF. Again, that is really a policy choice.

I think the analytic point that many economists would make is that if one is undertaking a lasting stream of spending without paying for that, then there is a lasting stream of deficits, which is what is very damaging. For unusual spikes of spending, there is a logic to not bumping up tax rates and bumping them down again to pay for that.

Mr. MCGOVERN. But these wars have gone on for quite a long time, and they will probably go on for a lot longer. So the idea that this is a short-term expenditure is not reality.

Mr. ELMENDORF. It has certainly not been short term.

Mr. MCGOVERN. The point I am just trying to make is, when you do these things and you don't pay for them, you are adding to our debt. And if we are talking about trying to control deficit spending, then, clearly, this issue should be on the table because we have been there since 2001. We are probably going to be there a lot longer than anyone wants to admit. I think we need to deal with this issue up front.

Thank you.

Mr. ELMENDORF. Thank you, Congressman.

Chairman SPRATT. Thank you, Mr. McGovern.

Mr. LATTA.

Mr. LATTA. Thank you, Mr. Chairman.

Director, thanks very much for being with us today. I represent the largest agriculture and manufacturing district in the State of Ohio. Our unemployment numbers just came out for the State just the other day, and we are not going down; we are going up. We are up to 10.9 percent statewide. My district is even worse than that because of the manufacturing that we have got. I have 4 of my 16 counties right now with 14 percent.

So when you talk about, you know, slow growth in job recovery, I can see it, because every week that I am home, I try to get out across my district. And my manufacturers are hanging on by their fingernails right now. They always turn to us and ask what we are going to be doing for them, and I cannot tell them right now.

And it is pretty tough because I hear you talking about these plants, that we are not going to see this recovery coming quickly, because you are absolutely right. A lot of these plants are down to 32 hours to try to save their brother and sister next to them on each machine. They have said, what do we do? And they have cut down to 32 hours on a lot of them, and you have got plant managers that are cleaning bathrooms and the outside contractors no longer working at these plants. So you have got more unemployment.

But you know, when I look at your testimony today, and it is very sobering, that the question when you look out to 2020, and you look at this massive amount of interest on the debt of $723 billion, or quick math about $2 billion per day, and when you look into your definition of, is that sustainable for this country to be able to pay $2 billion a day in interest on that debt?

Mr. ELMENDORF. We are a large and rich country. We can get away with a lot for a while. At what point we can no longer get away with it, as I have said, is very difficult to judge analytically.

Mr. LATTA. In going along, I tell my kids this all the time. I am not that old, but I started practicing law back in 1981. And when I started practicing law, of course, we were looking at 21.5 percent interest rates in this country and what was going on. And we were running on land contracts because people couldn't even go to the bank and get a loan because there wasn't any money to loan.

And when we are looking at this massive amount of interest that is going to have to be paid by the Federal Government, are we looking at what we stared at back in the late 1970s and early 1980s? Because, you know, a lot of businesses out there plan for the future. And if you are talking about jobs not being created, they are going to say there is absolutely no way I am going to buy that new machine or I am going to add more employees, because I am looking down the road now at what the Federal Government is going to be spending, and how are we going to go out and borrow money? Right now, I have companies that can't get any money right now. They actually have no debt, and they can't get a loan from the bank.

Mr. ELMENDORF. A few thoughts. As you know, interest rates were particularly elevated in the early 1980s because inflation was very high. So lenders demand—they want at least as much money back in real terms as they gave out. And then they want some real return on top of that. So the nominal reported interest rates were very high then particularly because inflation was very high.

We project that interest rates on the debt, government debt and other interest rates in the economy, will rise over the next decade, not to anything like the levels that were in place then. That projection is uncertain, but we think it balances the risks. So the burden is growing of making these interest payments. But it is not impossible. It is just a burden. In this case, analogies to individuals and families actually work pretty well. If you borrow a lot now, when you pay it back later, then it is squeezing what you can do later on.

I think on the other, businesses, the thing to say is that as the economy recovers and the financial system strengthens, the businesses you are talking about should be more able to get credit. Small businesses in particular are having difficulty getting credit now, and that is one of the restraining forces that we describe in our outlook on economic growth in the next few years.

But the healing of the financial system is underway. There has been actually tremendous improvement over the past year. It has not yet affected a lot of small businesses. But our expectation, the expectation of many analysts, is that it will over the next few years. And I am hopeful that it will.

Mr. LATTA. And I hope, too, because the thing is that we try to give hope to the folks out there that are right on the bubble right now; hopefully they will be in business in 6 months.

And just real briefly, it has been sort of touched on by the chairman and Mr. Ryan. I look at these numbers every month about the amount of foreign holdings out there of our debt. We have gone from, I think it was $561 billion over the last year alone. Watching this go up now that we have almost $3.6 trillion out there owned by someplace outside the United States, that is pretty sobering. And as this trend goes on, it is a good question. When are these other places or countries just going to say, you know what, we are not just going to be borrowing that debt and it falls back on the American taxpayer but also on these consumers out there and businesses? And that is what I worry about. When that bubble might break, we are going to see folks finding out that there is not—where are they going to borrow the money when the Federal Government had to up those interest rates? Then we are going to be staring at 1981, 1982 again. That is my fear. Thank you.

I yield back.

Chairman SPRATT. Ms. Tsongas.

Ms. TSONGAS. Thank you, Mr. Chairman.

And thank you, Dr. Elmendorf. It is a very sobering testimony we are hearing today. But also to look back at a year ago when we were hearing, yet again, a very sobering story from virtually every economist who recommended that the Federal Government had to act. The debate I felt was largely around what the size of a recovery package looked like, what its composition should be.

And as a new Member to Congress, I really took a lesson from a city I represent. It is the City of Lowell, Massachusetts. It is where the industrial revolution began. When the textile industry began to move south, it had a dramatic impact on the economy of the community, and government failed to act. And because government failed to act, it took decades for that city to dig itself out from under the challenges it faced. So that very real example really did motivate me and drive my decision to support the recovery package.

And I think from your testimony today, we have seen how important it was. We can't imagine where we might have been without taking that very bold action and again also listening to the lessons from the Great Depression. So I think you would agree that we had to move, and we had to move aggressively.

Mr. ELMENDORF. And I cannot suggest policy. But we do believe that the economy would have lost more jobs and suffered larger declines in GDP without the stimulus package.

Ms. TSONGAS. And would have taken many more years; we would be looking at a far different scenario today without it in terms of building ourself back.

Mr. ELMENDORF. It would have taken longer.

Ms. TSONGAS. I have another question, though.

And obviously, we all understand the long-term challenge of addressing the debt and deficit, and so when the President's budget is released, we have heard that he plans to propose a 3-year freeze, which we have been talking about, on nondefense discretionary spending. And I, like my colleagues, am pleased that he has taken the question of deficit control seriously. And I recognize that we are going to have to make some very painful choices that include spending cuts to our priorities.

But everything has to be on the table. Since nondefense spending is the smallest piece of the spending pie, even if we were to cut nondefense discretionary spending down to zero, we would still face a deficit in the hundreds of billions of dollars. Would you agree?

Mr. ELMENDORF. Yes, that is right.

Ms. TSONGAS. Nondefense spending is also the primary way the government fulfills its responsibilities to the middle class. Nondefense discretionary spending is really just jargon for public schools open to all, affordable college education, safe roads and bridges, poison- and toxic-free food and toys and so on. So as we have this very important debate, I think we in Congress will be sure to protect the middle class, understanding that we do have to address nondiscretionary spending as well as all other forms of spending.

But I have another question that really has to do with the commission. In light of the Senate's rejection of the commission yesterday, do you think we are going to see a negative reaction from the markets?

Mr. ELMENDORF. I would rather not predict financial market reactions. I think, among other things, markets tend to react fairly quickly, and I think the set of events over the last day or two have not been entirely unexpected. Some of that was built in already.

Some of the reaction has probably already occurred. It is difficult to predict.

If I could go back to your previous point about discretionary spending. I think you are absolutely correct that it is a category of spending that people often object to in general terms, but when it comes to specific aspects of it, there often are very strong support for pieces. In addition to the ones you mentioned, it is the category that funds health research, a certain amount of veterans benefits, the court system, national parks. A lot of specific elements that I think many people believe are an important part of what the government should be doing. And that is why, in fact, over time, it has proven difficult to reduce that substantially as a share of GDP. Because, in the end, for all of the general objections, there are a lot of specific things that the people want the government to do. That is why the choices that you face are difficult.

Ms. TSONGAS. But I agree. We have to put everything on the table and then be very careful about how we move forward. And yet addressing the long-term challenge that we face, because it is obviously, as you have said, unsustainable. Thank you.

Mr. ELMENDORF. Yes.

Thank you, Congresswoman.

Chairman SPRATT. Mr. Garrett.

Mr. GARRETT. Thank you, Director, for being here today. And I particularly also want to thank, you and your office, for the work you have done, what I think is the accurate accounting for the GSEs, government-sponsored enterprises, in the latest long-term budget outlook.

I will just spend a moment here first before asking a question, just laying out the history of how they came about and I think probably how you came to that conclusion. It was back in July of 2008 that Congress passed and the President signed the Housing and Economic Recovery Act of 2008, also known as Paulson's bazooka. This legislation gave the Treasury Secretary the power to buy an unlimited amount of securities from Fannie and Freddie if the Treasury Secretary determined a couple of things; that such actions are necessary, A, to provide stability to the financial markets; B, to prevent disruption in the availability of mortgage finance; and, C, to protect the taxpayer. Ultimately, they allowed the government to effectively take control of those companies if it deemed their losses to be a systemic risk to the U.S. financial system.

So then, in September of 2008, when the housing market continued to decline, Secretary Paulson basically fired that bazooka. And the Federal Housing Finance Agency placed Fannie and Freddie into a government conservatorship. Then, the beginning of last year, beginning in 2009, CBO concluded that Fannie and Freddie should now be included—this is an important point—CBO concluded that Fannie and Freddie should now be included in the Federal budget.

And according to a report issued by CBO in January, you arrived at this conclusion after considering the following questions: Who owns the agency? Who supplies its capital? Who selects its managers? And who has control over the agency's programs and budget? And ultimately CBO concluded the answer to those questions was, well, it is the Federal Government in each one of those.

But since then, the Treasury has continued to purchase preferred shares in the GSEs as a means to provide them with enough capital to recover their losses. Initially, Congress put up $200 billion. That is $100 billion for each entity. Then, last year, the Treasury raised that potential commitment to $400 billion, and of course, on the Christmas Eve of 2009, they lifted that cap altogether. And now it is basically unlimited.

In the latest quarterly report, Fannie Mae says, quote, we expect for the foreseeable future the earnings of the company, if any, will not be sufficient to pay the dividends on the senior preferred stock. As a result, future dividend payments actually will be effectively refunded from the equity drawn from the Treasury. Which, seems to me, is: the Treasury pours money in, and they take the treasuries, and they send our own money back to us again, as dividends.

Now, Director, your counterparts, however, at the Office Management and Budget, OMB, and Treasury somehow disagree with you and your conclusions about Fannie. They feel that the cost to taxpayers only equals the cost of the actual cash infusions that have been pumped into the GSEs. And they do not, as you do, account for the risk to the taxpayer—this may be your point—on the losses that the GSEs have sustained or will continue to sustain in the coming years.

Finally, a Wall Street Journal article said the administration has no plans to alter how it accounts for Fannie and Freddie in the Federal budget. "I don't anticipate any changes," said Assistant Treasury Secretary Michael Barr. They will have the same appearance that they have had before in the budget books.

So my first question is, is there any possible interpretation of the current relationship between the Federal Government and the GSEs that would allow you to change your opinion or, for that matter, any reasonable person to conclude that they should not accurately account for in our budget?

Mr. ELMENDORF. So, Congressman, as you know, we are always open to new information. We are not susceptible to persuasion apart from information.

Our judgment at this time, as we reiterated in the report we released a couple of weeks ago is that Fannie and Freddie are, as you say, financed and controlled by the Federal Government in a direct enough way that we believe they should be viewed as parts of the government for budget purposes.

But we do not in the end, of course, dictate the way the administration actually records the budget for years that are passed. But we are continuing, including based on discussions with the Budget Committees, to project the financial effects going forward on the basis we think makes the most sense.

Mr. GARRETT. So you concluded that, for the analysis reasons that you laid out, that that was a reasonable conclusion to place them on budget is basically what you are saying?

Mr. ELMENDORF. Yes, absolutely. And if the relationship changes over time, then, of course, we will revisit that conclusion.

Mr. GARRETT. But where we are right now, a reasonable interpretation, we place them in the budget, that a decision by the Treasury and the administration is contrary?

Mr. ELMENDORF. That is correct.

Mr. GARRETT. Thank you. And this is not an inconsequential decision as to whether it is on budget or not, is it?

Mr. ELMENDORF. Well, it mattered most for the budget numbers last year because, by our assessment, absorbing those companies then put the Federal Government on the hook for the risk the companies bore.

So the biggest difference in the budgetary cost was actually for last year. Looking ahead this year and beyond, the cash infusion, the way the administration wants to record it, and our version of the subsidy cost are calculated differently. As it turns out, at least at the moment, the numerical differences are not that large.

But it is potentially important beyond the baseline projections in how one would estimate the effects of various changes in what Fannie and Freddie do, or changes in their relationship with the Federal Government. Which is why we think it is very important that we continue to score them on the basis that we have established.

Mr. GARRETT. Right, and I guess on the last point—I know my time has already expired. In light of your consideration on how it is done and the assumptions that you make as time goes along, if things don't turn around over there, your number could go up, if you were on budget under your interpretation, could go up dramatically in light of the trillions of dollars of risk that is exposed, correct?

Mr. ELMENDORF. Yes, that is correct.

Thank you very much.

Chairman SPRATT. Mr. Etheridge.

Mr. ETHERIDGE. Thank you, Mr. Chairman. Let me thank you for holding this hearing.

And, Dr. Elmendorf, thank you for being here. I appreciate it very much. And I am glad to hear what you have had to say this morning, I am glad to hear that some economic indicators indicate that we are beginning to turn around in the economy.

However, we all know that the job market is critical, and it appears that those lagging indicators are really hurting. And let me tell you why they are so important to me, and I think a lot of others, especially in my State of North Carolina. We just reached an all-time high of 11.2 percent in the month of December. And there are indications that we haven't topped out.

I have introduced a bill, H.R. 4437, the Hiring Act of 2010, to help businesses, really a tax credit for job creation, to help those folks who are on the fence, sort of to push them off.

In your opinion, why do you think the unemployment rate remains high, even in the face of economic growth? You have touched on this some. And secondly, how does CBO estimate improvement on this front? How do we get there? And finally, we intend, through the Hiring Act and there are other bills out there that are similar, to increase job creation in the short term, and what kind of impact would that have on the projection numbers that you have over the long term?

Mr. ELMENDORF. Congressman, I have not examined your particular bill.

But, in general, we did analyze alternative ways of spurring economic growth and job creation. And we think that one of the more effective ways are policies that are targeted at, basically, give money to firms in response to increases in their payroll.

Mr. ETHERIDGE. That is what this one does.

Mr. ELMENDORF. And that works in two ways really. Part of that is just that putting money into the spending stream, giving more money to workers or to firms will encourage a certain amount of extra spending.

Additionally there is this incentive effect if the program is structured right, and there are a lot of complexities as you know in that, it can create this incentive effect additionally.

If a policy like that were implemented, we would incorporate its effects in future—we would try to estimate the economic effects of it as it was being considered. And we would certainly incorporate its effects in our next round of baseline projections. But I cannot say offhand how much difference that makes.

Mr. ETHERIDGE. Good. Thank you. I understand that.

Now, on the larger question of the economy, I agree, we need to have common sense and cooperation to fix the problem. And I wish Mr. Campbell were here, because he said, where we are is unsustainable. And that is true. It also was unsustainable last year and the year before that and the year before that and during the years that the previous administration was in charge.

Mr. ELMENDORF. Yes, that is right.

Mr. ETHERIDGE. And there were things done then that has added to the problem we are in.

And here are some of them. Because in 2000, I came here early enough to work on a cooperative way to set us on the path to a balanced budget and a surplus that we picked up in 2000. Policies were put in place shortly thereafter in the first Bush years that made the problem even worse, because we were told then that we could pay off all of our debt by where we are today. But there were those that said, that was not important.

As a matter of fact, Vice President Cheney said deficits don't matter. If he is listening, I want him to understand that debts do matter. And now this is the consequence of actions that were taken. Debts matter; they matter to our children.

So my question is this, as we are looking to broader growth, we need a bipartisan approach again. We don't need the partisan issues that are out there. It is going to take everyone working together, holding hands, making tough decisions to replace 8 years of partisan politics. We can't go back to that if we want to get the job done that will make a difference, so the people who live in my district, whether they are on Main Street or on a country road, start enjoying some of the same benefits that the people on Wall Street are now enjoying.

And we aren't getting jobs. So how do we make these things fit from an economic standpoint so that this economy starts to grow and everyone is able to sit at the table again rather than sit at the end of the chair and get a few crumbs?

Mr. ELMENDORF. You ask a very important and very, very difficult question, Congressman.

It has not been a good period for many American families. And trying to adopt policies to encourage overall growth and also to ensure, as you would like, that that growth be shared in certain ways is very difficult. And it is made more difficult by the very large deficits and growing debt that exist under current policies.

And we are—one of the areas that we plan to devote a good deal of effort to at CBO in this coming year, in fact, is working on programs in the income security and education area, doing the sorts of analysis that we hope will help you to make decisions in that area in an informed way.

I don't have a cookbook handy with particular recipes to pass you. But I do think that doing that while also taking note, as you say correctly, that the debt matters will be a very great challenge.

Mr. ETHERIDGE. Thank you, Mr. Chairman.

And I welcome that report.

Thank you and I yield back.

Chairman SPRATT. Thank you, Mr. Etheridge.

We have 7 minutes and 17 seconds. And what we can do, Mrs. Lummis, is let you ask your questions and then we have got to go vote twice. There is a 5-minute vote following this one. Let us take yours up, and then we will leave here—we will hold you to 5 minutes and leave here with 2 minutes to go.

The floor is yours.

Mrs. LUMMIS. Thank you, Mr. Chairman.

Thanks, Mr. Elmendorf.

So I am going to go really fast, rapid fire. If we want to address the structural deficit, which is better for the U.S. economy in the long run, cutting Federal Government spending or raising taxes?

Mr. ELMENDORF. Well, raising taxes, depending on how one raises them, can have important effects on people's incentives to work and to save. And if taxes are raised in a way that discourage work and saving, that would have dampening effects on economic growth that would offset the advantages of less debt.

Similarly, government programs, on the spending side, can have effects on incentives to work and to save. And the ways in which those programs are changed can have incentive effects as well. So I don't think there really is a clean answer that it should be on one side of the budget or the other.

It depends much more I think on adopting policies on either side of the budget that take account, not just of the overall effects on the deficit but also the effects on people's incentives.

Mrs. LUMMIS. Who is better for the economy in the long term, a Federal Government employee or a private-sector employee?

Mr. ELMENDORF. I won't take that personally, Congresswoman.

Look, we have to decide as a society what we want the public sector to do and what we want it not to do. And I don't think there is a simple answer to that question. Both employees will spend money. They will buy things that will help create jobs for other people.

It is really a matter of judgment about what one wants the economy to be like and how much we want to be in the public sector versus the private sector, as the debate which is taking place around health care to some extent. But there isn't a simple economic answer to that question.

Mrs. LUMMIS. Does the private-sector employees' taxes help pay for the position of the public-sector employee?

Mr. ELMENDORF. Yes.

Mrs. LUMMIS. Okay. Thank you.

Which is worse in the long run, crowding out private investment with government borrowing or higher taxes that slow private growth?

Mr. ELMENDORF. I think it depends critically on the nature of the taxes and how much they slow private growth. And as you understand very well, not every tax increase is the same. Not every spending cut is the same, and it matters very much what specifically you would do in policy terms.

Mrs. LUMMIS. In this economy, if you had to raise taxes, what tax would you raise first that you believe would have a positive effect or a less negative effect on the economy?

Mr. ELMENDORF. I am sorry, Congresswoman. And I am not trying to be difficult. I have not really thought carefully about ranking possible tax increases in that way.

Mrs. LUMMIS. Okay. I want to talk a little bit about the PAYGO rules. You mentioned earlier that the PAYGO rules of the 1990s helped. And I have heard that, too.

But I have also heard that the PAYGO rules that we passed last year had so many loopholes and exemptions that they weren't the same as the PAYGO rules that were in effect in the 1990s. Is that true?

Mr. ELMENDORF. So the PAYGO rules—yes, the PAYGO rules that you passed last year exempt significant amounts of prospective tax cuts and some spending increases from the PAYGO requirements.

Mrs. LUMMIS. So would it be more meaningful if we went back to the PAYGO rules that were in effect in the 1990s, in terms of trying to address the structural deficit in the long term?

Mr. ELMENDORF. Yes. So if you adopted a PAYGO rule that did not exempt any prospective policy actions, that would have a sharper effect on holding down budget deficits.

Mrs. LUMMIS. Okay. What if we froze the top line of Medicare, Medicaid, Social Security and the very same discretionary spending that the President announced for tonight's speech for the same time period, how much would that save?

Mr. ELMENDORF. I cannot think of the calculation offhand, but it would certainly save a great deal of money. I think the policy challenge is to decide, if one puts a top line cap on Medicare spending, what does that mean to Medicare beneficiaries? Who is it that won't get paid the amount they would have been paid without that cap?

Mrs. LUMMIS. Let's say that you reduce the benefits to wealthy Americans, who did pay that money into Social Security, means tested the payouts and did it that way?

Mr. ELMENDORF. On the Social Security side, where one is picking a sort of dollar amount up front, it is easier to change those rules. And one could do the sort of thing you suggest. Exactly how much you would save depends on just what thresholds you picked and how the testing worked.

Mrs. LUMMIS. Mr. Chairman, thanks a million.

Thanks, Mr. Elmendorf.

Mr. ELMENDORF. Thank you Congresswoman.

Chairman SPRATT. I am going to yield the gavel to Mr. Edwards from Texas. And he is going to ask some questions. He will have the power to recess if he needs to get to the floor himself. I am going to go cast two votes, and I will be back.

Mr. ELMENDORF. Thank you, Mr. Chairman.

Mr. EDWARDS [presiding]. Thank you, Mr. Chairman.

Dr. Elmendorf, thank you for being here.

I applaud President Obama for taking a significant first step toward getting this deficit under control, and I applaud those Republicans, such as, I believe, Senator McCain and others, who have said they will support it. It is somewhat disappointing to me that some of my Republican colleagues on this committee who had the majority for 12 years and helped, through their partisan budgets—passed into law without Democratic support—lead us from the largest surpluses to the largest deficits in American history.

And perhaps it is insight into why we have the deficit problem that we have today when some of my colleagues would suggest it is not significant that we are going to, through this 3-year freeze, be able to reduce the deficit by $250 billion more than it otherwise would be.

I am still hopeful we can build some bipartisan support for deficit reduction programs, short term and long term, because I don't think either party has the political will or the political ability to make the tough choices to get us where we need to be.

But I do want to go back and not focus on the past, but I do want to be sure we understand how we got into this ditch so we can figure out how to not drive the car into the ditch again.

And I would like to begin with this question. In 2001, when President Bush took office, what was CBO's projected national debt for the year 2010, approximately?

Mr. ELMENDORF. I don't know, Congressman. We don't have that number with us. I am sorry.

Mr. EDWARDS. Wasn't it close to zero national debt?

Mr. ELMENDORF. That seems plausible.

Mr. EDWARDS. So if you could get that for me, I would appreciate it. But as I recall in 2001, the CBO, when President Bush took office, the CBO was projecting—at that time, we had about a $5 trillion national debt and there was a projection of about $5.5 trillion of surplus. So my math tells me that would have been a projection of having the national debt paid off by the year 2010. And if you could verify those numbers, I would appreciate that.

Mr. ELMENDORF. Yes, we will check that.

Mr. EDWARDS. What is the national debt today?

Mr. ELMENDORF. Debt held by the public by the end of this fiscal year we think will be about $8.8 trillion.

Mr. EDWARDS. And the total national debt today.

Mr. ELMENDORF. Well, if you mean the gross—there are a lot of measures of debt. Gross debt is on the order of $12 trillion. That includes, as you know, debt held by the public and also debt held by other parts of the government.

Mr. EDWARDS. So instead of the projected situation where we would have no national debt, gross debt, by the year 2010, projected when President Bush came into office, in fact we have a gross debt of about $12 trillion. So approximately a $12 trillion turnaround from what was projected with the policies in place in 2001. Is that approximately correct?

Mr. ELMENDORF. I think, Congressman, that the numbers you are thinking about for the 2000 projection would have referred to debt held by the public. It was not gross debt that would have gone to zero because there would have been bonds held in the Social Security and Medicare trust funds that would have been part of gross debt. So I think it is debt held by the public that you started with and that you are correctly focused on because that is what really measures the government's effect on the economy. And that is a number that we think again this year will be about $8.8 trillion, and that would have been, we think, in the neighborhood of zero. We will check to be sure.

Mr. EDWARDS. Wasn't there a projection that there would be about a $5.5 trillion surplus over a 10-year period if you go back to CBO's projections in 2001?

Mr. ELMENDORF. That may well be, Congressman. I just don't have a personal recollection of that. We will check for you.

Mr. EDWARDS. So instead of—at the very minimum, instead of having zero public debt in the year 2010, we have about $8 trillion?

Mr. ELMENDORF. Yes, more than $8 trillion——

Mr. EDWARDS. In public debt. The gross debt is actually worse than that, $12 trillion. So an incredible turnaround.

During—I just want to get this for the record. During the 12 years that the Republicans had a majority on this Budget Committee and passed the budget resolution without Democratic votes, did they ever pass through this committee or in the House or through the Congress a 3-year freeze on nondefense discretionary spending?

Mr. ELMENDORF. Not that I am aware of, Congressman, no.

Mr. EDWARDS. During those 12 years that the Republicans had the majority on this committee and passed every budget resolution they passed out of this committee on a partisan basis, did they ever pass on the floor of the House or into law a long-term reform proposal to reduce the cost of entitlement spending?

Mr. ELMENDORF. Not that I am aware of, no, Congressman.

Mr. EDWARDS. In fact, the reality is that, without Democratic votes, under the leadership and push of Tom DeLay in the wee hours of the morning, isn't it correct that the Congress under Republican leadership passed the largest increase in Medicare funding since Medicare was created, the Medicare Part D prescription program? Was that the largest increase in Medicare entitlement spending since Medicare had been created?

Mr. ELMENDORF. Yes, I think that was the largest increase—obviously the numbers have increased over time based on the cost of providing benefits already written into law. In terms of the expansion of benefits, that was a very significant expansion, and it was enacted without any particular means of paying for it being identified.

Mr. EDWARDS. So, in fact, it was passed without being paid for at all; is that correct?

Mr. ELMENDORF. Yes, Congressman.

Mr. EDWARDS. All of that money was borrowed in effect?

Mr. ELMENDORF. Right.

Mr. EDWARDS. What does CBO project the 10-year cost of the Medicare Part D prescription program to be?

Mr. ELMENDORF. That is a good question which I should know the answer to, but I don't offhand.

Mr. EDWARDS. Can somebody give me a ballpark? Or 10 years from the time it was passed. What was the 10-year cost?

Mr. ELMENDORF. So I am not sure, Congressman. The actual cost is coming below CBO's estimate, even further below the estimate of the Office of the Actuary at the Centers for Medicare and Medicaid Services, but still, obviously, a very substantial amount of money. I don't know what the 10-year number would be corresponding to the initial 10-year estimate.

Mr. EDWARDS. I have heard between $500 billion and $700 billion over a 10-year period. Do you think that is the approximate range of costs—the 10-year costs—of the Medicare expansion program that was passed without being paid for and passed by Republicans when they controlled the Congress?

Mr. ELMENDORF. Those numbers sound a little high to me for the decade beginning with enactment. But we will check for you, Congressman, and respond to that question.

Mr. EDWARDS. Okay. I think it is somewhere in at least the half a trillion dollar range, none of which was paid for.

Can you tell me, Dr. Elmendorf, how much the 2001 and 2003 tax cuts have increased the national debt as of today?

Mr. ELMENDORF. I think I am 0 for 3 with you Congressman. I don't have an assessment of cost of that over the past decade.

A related fact which may be interesting to you is that, in the deterioration in the budget outcomes over the last decade relative to the projection that we made 10 years ago, about two-thirds of that deterioration has come from legislative changes in our estimation, and about a third has come from economic and technical factors that were less favorable than we expected.

Mr. EDWARDS. Do you have a ballpark? Did the Bush tax cuts of 2001 and 2003 on a 10-year basis add more or less than a trillion dollars to the national debt?

Mr. ELMENDORF. I believe a good deal more than the trillion dollars, Congressman.

Mr. EDWARDS. More than $2 trillion perhaps?

Mr. ELMENDORF. So there we go. So we think over the 10-year—the appropriate 10-year window, which in this case would be the 2002 to 2011 fiscal years, that the cost of the 2001 and 2003 tax cuts is about $1.5 trillion, not including the extra debt service that has resulted from it.

Mr. EDWARDS. Okay. Do you know what the number is with the extra debt service?

Mr. ELMENDORF. No, I don't think we have done that calculation of the debt service. As you know, we estimate the effects of debt as a whole. We can do a partial estimate for this piece, but we have not done that.

Mr. EDWARDS. But when you increase the deficit, debt service is a real cost of increasing that deficit; is that correct?

Mr. ELMENDORF. Yes.

Mr. EDWARDS. So a minimum of $1.5 trillion has been added to the national debt as a result of the 2001 and 2003 tax cuts. And if you add in interest, it could be over $2 trillion perhaps. Okay.

Some of my colleagues in Congress, just a few weeks ago, were proposing a complete repeal of the estate tax. In fact some of my colleagues who, in this committee, talk a great deal on a regular basis at every opportunity about the importance of not adding debt to the next generation and our moral obligation to our children. Some of those same members who voted for the budgets that led to the largest deficits in American history after they inherited the largest surpluses, also supported repealing the estate tax completely. Do you have a 10-year estimate of the cost of the complete repeal of the estate tax?

Mr. ELMENDORF. We may. I don't know offhand. Just a moment.

Mr. EDWARDS. I realize you are not the director of the Ways and Means Committee. So I understand you are not having exact numbers on all of these questions. I would welcome the follow up. But some approximate number?

Mr. ELMENDORF. I think we don't know. We will have to get back to you on that. As you say, this is the Ways and Means Committee; on a staff level, the staff of the Joint Committee on Taxation does those estimates. And we can check on what the numbers are.

Mr. EDWARDS. These certainly have a direct budget implication. That is why I would appreciate the answers to these questions in writing if you could.

I have heard numbers as high as $700 billion being added to the national debt if we had a complete repeal of the estate tax. Does that sound like ballpark costs in terms of extra national debt to you?

Mr. ELMENDORF. I am sorry, Congressman. We just don't know. We bring a lot of numbers in our heads and a lot of numbers in our notebooks, but not every number, and we have not aligned with your questions very well I am afraid. But we will send that to you in writing.

Mr. EDWARDS. I believe that might be the ballpark number. If we did what some members of this committee who talk about reducing the deficit on a regular basis, if we did what they wanted to do, I think that would add somewhere between a half a trillion to an extra $700 billion to the national debt over a period of time.

Could I just—why don't we do this then, could I just ask you for the record, in addition to answering the questions I have asked, if you would also answer the questions of what the 10-year cost would be of other tax proposals that have been made. One of them has been reducing the corporate tax rate by perhaps 5 percent. I would like to know what the increase to the national debt would be if we reduce the capital gains tax by 5 percent. And would you happen to know off the top of your head what the AMT fix, a complete AMT permanent tax fix would cost—how much that would add to the national debt over 10 years?

Mr. ELMENDORF. For that we actually do have an approximate number reported in our outlook. Over the next decade, indexing the AMT for inflation, a particular version of what one might mean by a fix, would reduce revenue by $558 billion and would also have a debt service cost beyond that over the next decade of $125 billion.

Mr. EDWARDS. You know, we will be able to tell more specifically when you get the numbers, but the bottom line is, by my math, if you were to pass some of these tax proposals that some of the folks who give a lot of deficit hawk speeches but turn into deficit doves when it comes to the tough decisions to balance the budget—if they were to pass all the tax cut proposals that they have recommended, you could not only freeze the nondefense discretionary budget, you could eliminate the entire discretionary budget, probably including the national defense budget, and still not balance the budget.

Am I clear in response to Mr. Doggett's questions, you said that if we were to extend all of the 2001 and 2003 tax cuts that were passed on a temporary basis under the guise of being able to do that fiscally responsibly, for those who want to extend all of those permanently, did I understand that was a $4½ trillion cost over 10 years, or was there a different number there?

Mr. ELMENDORF. So if one were to extend the expiring tax provisions that you say from 2001 to 2003 and also index the AMT for inflation, those set of policies together would add about $4½ trillion to deficits over the next 10 years, including the debt service that would result from the changes.

Mr. EDWARDS. Dr. Elmendorf, you said earlier it is your opinion that no single step, either on the entitlement side or the discretionary side of spending or on the tax side, no single step is going to bring us back into a balanced budget; is that correct?

Mr. ELMENDORF. I think it is very unlikely that a single step would do that, because the magnitude of the gap between spending and revenues is so large that to try to close that gap, if that were your goal, only through one component of spending or of revenues would require radical changes in that component.

Mr. EDWARDS. Would you agree that the proposal that was not ever made or passed under Republican leadership in the Congress over the last decade or so, the proposal that President Obama has put forward now to have a 3-year spending freeze on nondefense, nonsecurity discretionary spending, that that—would you agree that that is a significant, substantive step forward toward reducing the national deficit?

Mr. ELMENDORF. As I have said before, it is a step in the direction of reducing the deficit. According to the newspaper accounts, it is a small step relative to the overall deficit that we project over the next 10 years. But beyond that we just need to wait to see the actual proposal and to do our analysis of it.

Mr. EDWARDS. Do you think it could also—I think it is a very significant step forward. I can understand you in your position being hesitant to add adjectives to these steps because you are in your position on a nonpartisan basis, and I respect that. But don't you think there is some benefit to the—there could be some significant benefits to the private markets and the capital markets if they were to begin to see Congress taking—and the President—together on a bipartisan basis taking significant steps, real steps, meaningful steps to get the deficit under control?

Mr. ELMENDORF. I certainly think that bipartisan steps that would change the trajectory of the Federal deficit could have a very positive effect on financial markets' concerns about where that deficit is headed.

Mr. EDWARDS. I want to thank you for answering my questions. And the other questions I would just look forward to in writing. In fact, if your staff could look at any of the major tax cut proposals that have been proposed by Democrats or Republicans over the last 6 to 8 months, if you could put a 10-year cost on those and include that in your answer, I would welcome that.

Mr. ELMENDORF. We will provide as many answers as we can as quickly as we can, Congressman.

Mr. EDWARDS. Thank you, Dr. Elmendorf.

And at this time I would like to have the committee recess subject to the call of the Chair. Thank you.

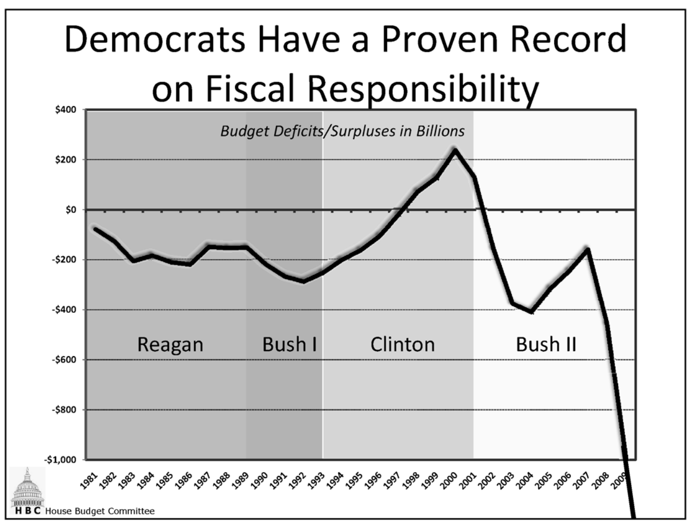
[Recess.]

Mr. BECERRA [presiding]. The committee will reconvene and be called to order.

Dr. Elmendorf, we will continue with the question-and-answer period. And I would now like to turn to my colleague from Virginia Mr. Scott for his questions.

Mr. SCOTT. Thank you, Dr. Elmendorf. Thank you.

I would like to call up the first chart. It is this one you are looking at. As you can see, this is a chart of the deficit going back to 1980, and you will notice the blue bar shows the deficit, a significant deficit, was inherited, eliminated, and we went up to surplus. The projected 10-year surplus after the year starting in 2001, 10-year surplus was about $5½ trillion. What happened in 1993 to create that chart, the blue part of the chart?



Mr. ELMENDORF. As you know, Congressman, during the 1990s, there were significant policy actions taken to narrow the deficit. There was also an economic recovery and boom that increased revenues and reduced spending, which further narrowed the deficit.

Mr. SCOTT. Votes were taken in 1993 that—did the votes in 1993 help create that chart?

Mr. ELMENDORF. Yes, they did, Congressman.

Mr. SCOTT. And what happened in 2001?

Mr. ELMENDORF. Well, so as you know, the economy was in recession, and also there were legislative actions taken that widened the deficit.

Mr. SCOTT. Wait a minute. In 2001?

Mr. ELMENDORF. Excuse me.

Mr. SCOTT. When did the recession in 2001 start?

Mr. ELMENDORF. Well, I actually have that. The recession started in March of 2001 and ended in November of 2001. That is a calendar-year basis. These are probably fiscal year.

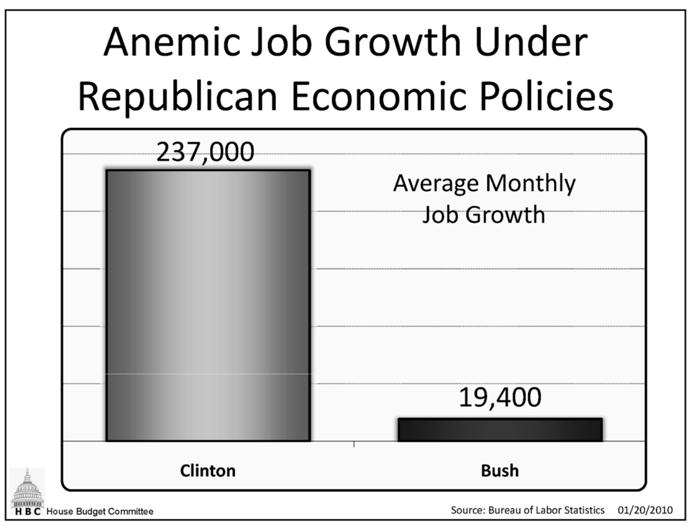
Mr. SCOTT. Okay. After the Bush administration came in, then the recession started. The Bush administration did not, quote, inherit a recession; is that right?

Mr. ELMENDORF. The National Bureau of Economic Research dates business cycles. They dated the recession as being in March. I think analysts would agree that the——

Mr. SCOTT. And instead of a 10-year, $5½ trillion surplus, we ended up with, what, a $3½ trillion dollar deficit for those—debt for those—additional debt for those years of about $9 trillion?

Mr. ELMENDORF. I don't have the numbers at hand. As you know, and as the picture shows, there were very significant deficits during this decade.

Mr. SCOTT. And notwithstanding the fact that the Bush administration overspent the budget $9 trillion—can you present the next chart—the jobs created under the Bush administration were about the worst since when?



Mr. ELMENDORF. I don't have those facts. But it is, I believe, true that net job creation over the past decade has now been essentially zero.

Mr. SCOTT. And that is the worst since the Great Depression or in an 8-year period.

Mr. ELMENDORF. That may well be. I am not sure, Congressman.

Mr. SCOTT. We obviously are in a very challenging situation where we are trying to create jobs. What impact does the fact that over the last 8 years we have overspent the budget a trillion dollars? In addition States are cutting back significantly. What does that do to the challenge we have in trying to stimulate the economy to create jobs?

Mr. ELMENDORF. It makes it harder. There is no doubt that in the late 1990s, there was a discussion about the importance of budget surpluses, partly because they put the country in a better position to deal with future needs. And by coming into this financial crisis and recession with a budget that was already in deficit with a substantial amount of outstanding debt, we were not in as good a position to deal with the needs that people felt then as we would have been if there had been less debt accumulated in the preceding years.

Mr. SCOTT. And if we spend—part of the stimulus package was several hundred billion dollars of aids to the States. In addition to that, they have cut back. Is it true that we would almost have to spend $500 billion just to offset what the States have cut back in just to get back up to zero?

Mr. ELMENDORF. I don't have a specific number, Congressman, but certainly estimates have been that the States, the budget shortfalls of the States during this period of several years would be in the hundreds of billions of dollars. Just for 2010 alone, the National Association of State Budget Officers reports that States made changes in their budgets, took budget-tightening efforts exceeding $100 billion just in that fiscal year.

Mr. SCOTT. So the first $100 billion would just get us back up to zero in terms of stimulus?

Mr. ELMENDORF. So what happens in recessions, as you know, is that government revenues decline. Spending on certain programs tends to move up. That widens budget deficits, as happened at the Federal level. At the State level, because of balanced budget rules, they can't persist in that way, and they take actions to offset that. So essentially they are forced to take legislative actions that offset a good deal of the automatic stabilizers that would otherwise arise from their budgets, and thus their net stimulative effect is really quite small.

The Federal Government does not have those restrictions; it can run larger deficits. And we think one of the channels through which the stimulus package strengthened the economic activity was by providing funds to States that then reduced their need to raise other taxes or cut other spending.

Mr. SCOTT. And that is part of the challenge, because we are shooting at a moving target. Every time we spend some more money, the States are cutting money. And one of the challenges that we have, we are trying to get ahead of the curve so we are actually stimulating the economy, not just maintaining the bad economy we have.

Mr. ELMENDORF. It is—yes, I mean, it is true that the economy has—despite the stimulus, and despite what we think are the positive effects of the stimulus, the unemployment rate has risen higher than we expected it to. We think that is a reflection of the depth of the underlying economic problem, and that is what the efforts to stimulate economic growth and stimulate job creation are trying to push against.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. BECERRA. Thank you, Mr. Scott.

Dr. Elmendorf, a few questions for you. I have an interesting statistic I would like to share with you. And your level of knowledge and your acuity with numbers is renowned, but I think I am going to stump you on this one.

Mr. ELMENDORF. As we have seen, Congressman, it is all too easy to stump me.

Mr. BECERRA. You have a moving train, I think pretty average size of about 150 freight cars on this train traveling at a pretty average speed of about 50 miles an hour. How long does that train travel from the point where the engineer pumps the brakes and says, we need to do an emergency stop of this 50-mile-an-hour moving train.

Mr. ELMENDORF. You have stumped me, Congressman, but I think it would take some distance.

Mr. BECERRA. And by "some distance," do you have a sense of measurement?

Mr. ELMENDORF. I wanted to be a train engineer when I was a kid, but I never got to the point of figuring out how good the brakes were.

As you are saying, Congressman, the U.S. Government and the U.S. economy have a substantial amount of momentum in what they do and how they perform. And to use policy decisions to turn the government or to turn the economy is very difficult because of the size and the momentum that they have.

Mr. BECERRA. And so the reality is that in good times we could actually make a few mistakes and still be in pretty good shape, because the economy as a robust engine will drive that train at 50 miles an hour whether we want to brake it or if we happen to enact policies that would actually take it in the wrong direction?

Mr. ELMENDORF. Yes, that is right.

Mr. BECERRA. Would it surprise you to know that it takes about a mile and a half to stop that 50-mile-an-hour traveling train that has about 150 cars loaded on it?

Mr. ELMENDORF. I didn't know it was that far.

Mr. BECERRA. A mile and a half.

Mr. ELMENDORF. Interesting.

Mr. BECERRA. And so if that 50-mile-an-hour train that we call the U.S. economy is doing very well, as it was in the 1990s when we were creating 22 million jobs, even some mistakes done by policymakers, that economy could absorb. And so in the year 2000, at the end of the year 2000, had you been sitting as the Director of the Congressional Budget Office, you would have been telling us we are looking at budget surpluses for as far as the eye can see totaling something over $5 trillion, correct?

Mr. ELMENDORF. Yes, I think that is right.

Mr. BECERRA. And so with the inauguration of a new President in 2001, you would have been advising that President, Mr. President, you are looking at a $5.6 trillion deficit over the next 10 years?

Mr. ELMENDORF. Surplus, yes.

Mr. BECERRA. And that is the train that is moving in that direction.

Unfortunately, you were not the Budget Director in the year 2001, you are the Budget Director in 2010, and rather than looking at a budget surplus, you are advising this Congress and a President that we are all looking at massive budget deficits. But those deficits that are massive weren't created last night or even last year, correct?

Mr. ELMENDORF. That is right. As I said in my remarks, there is an effect of the financial crisis and a recession and recent policies that is also a very important effect of the underlying policies built over a period of many years.

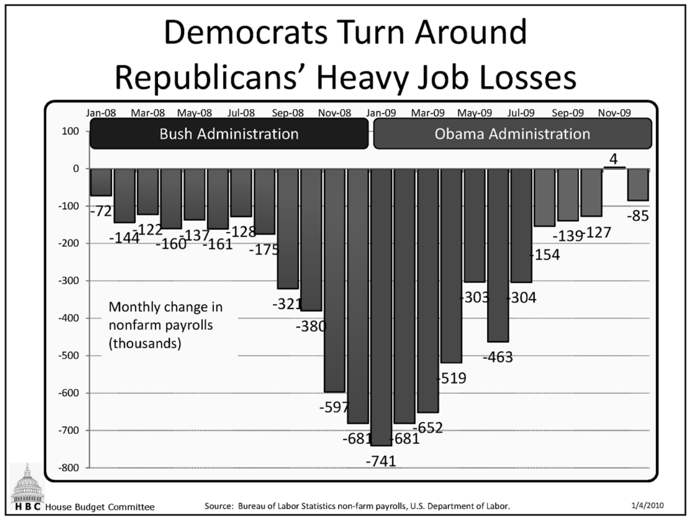
Mr. BECERRA. And so this fast-moving train is now moving in the wrong direction on the economy and deficits. But somehow we went from a train 8 years ago that was heading in the right direction with $5.6 trillion in surpluses for 10 years to budgets that are looking at deficits that are close to a trillion and a half strong in a year, and somehow that train turned with some bad policies and obviously bad economic conditions along the way.

Do you think we are beginning to brake that downfall, the "stuck in the ditch" situation that we have been in in the economy for the last several years?

Mr. ELMENDORF. Certainly we think that the economy has begun to grow again. The data for the second half of last year show an expansion of production. As I said, we think that expansion will be slow, and that traditionally employment lags, and we think that will mean a particularly weak performance of the labor market for some time. But the direction, we believe, of economic activity is up, and we expect that at some point this year that the unemployment rate will start to turn down, that employment, number of jobs, will turn up.

Mr. BECERRA. And when you talk about the labor market, which should concern us perhaps more than anything else if we are serious economists—obviously we all talk about interest rates and GDP, but the most important thing beyond interest rates, GDP should be J-O-B, and that is what an American wants to know is that he or she has a job that will bring us in revenues, tax payments so we could have a robust budget.

If I could have chart 6 put on the screens.



We were seeing massive job loss. A year ago we were receiving word from you and others that we were going to be losing jobs. We found out it was close to 750,000 or so jobs that we lost in a month. That is about 24,000 jobs a day that we Americans were losing in this country. We are still losing some jobs. We actually had some job growth in November of this past year, a couple months ago, but still on the whole we are still losing, but nowhere near that number. And as the chart reflects, we are beginning to see the end of this trough that we were in, this massive ditch that we were in, which is good. But we still must do—we still have to generate more economic activity to really see us break into the plus when it comes to jobs, when it comes to our budgets and their deficits to turn into surpluses. So it is going to take some time for us to get out of that ditch; is it not?

Mr. ELMENDORF. I think that is right. And the crucial point is that getting back to zero is not enough, because there is a very large pool of people who are currently unemployed, and other people who are not measured as unemployed because they have given up on looking for work right now and are not counted in the labor force. And it will take a tremendous amount of job creation to put everyone back to work who is looking, who would like to have a job.

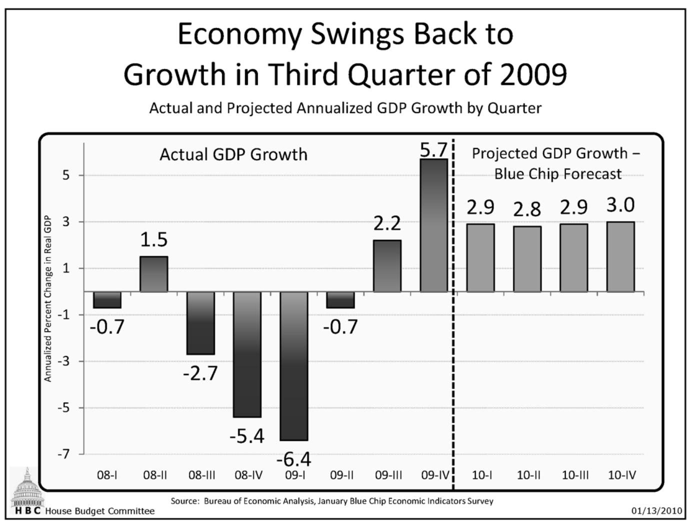
Mr. BECERRA. And to sort of put graphically what you have just said, if we take a look at the chart, essentially we saw how things were just going deeper and deeper into a ditch. The President takes office; 741,000 jobs lost. Enough has been done probably by this big economic engine we call the economy, whether with or without policy initiatives, to start to turn around on its own, but hopefully some policy initiatives have begun to help to turn that around.

But whether you are liking the blue bars that are leading to less job loss, and hopefully at some point job gain, those are still jobs lost. So you have to add every single bar, red and blue, together to calculate the number of Americans who are out of work or who have lost a job. And it is not until we pass that zero line and start to break that zero line that we can actually say we have offset one of those Americans that represents part of that—any of those bars before we can say we are putting people back to work net.

Mr. ELMENDORF. I think that is exactly right. The official statistics show that more than 7 million people have lost jobs. The Bureau of Labor Statistics has already announced there will be a— they call a benchmark revision—that will add more loss so that shortly it will measure 8 million lost jobs. And normally in a growing economy with a growing population, the number of jobs increases over time. So the shortfall relative to what would have occurred without this recession is more than 8 million lost. It is maybe 10 or 11 million is the shortfall that will need to be made up.

Mr. BECERRA. So we essentially are applying the brakes on that economic train that was taking us further and further down into that ditch. We have begun to see those policies break that fall, but it is going to take a mile and a half to stop that train. It is not going to happen in 1 day, in 1 year or in 100 yards. It is going to take a mile and a half to stop that economic engine we call the U.S. economy that was traveling 50 miles an hour with 150 cars on it straight to the bottom.

Now, if I could get chart 4 up.



We are seeing the changes; we see the job numbers getting better, and we see the economic numbers getting better for the GDP. Now let us talk macroeconomics, the economists' numbers, not the American workers' numbers and letters.

The GDP is getting better, which simply means that we are seeing more economic activity, which then means that there are more companies in America or businesses who are willing to hire because I am selling more, I need to produce more. If we continue to see the blue bars showing economic growth, at some point we are going to start to break that line where we are losing jobs and actually start creating jobs, correct?

Mr. ELMENDORF. Yes, that is right. We think that might happen soon.

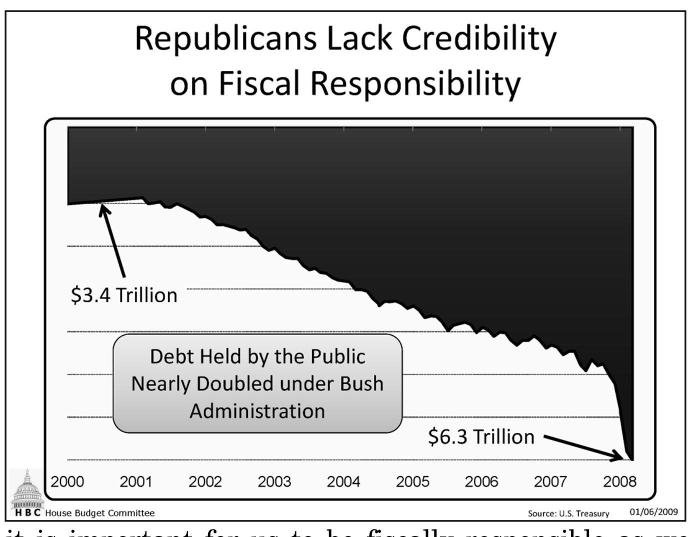
Mr. BECERRA. How soon? And again, it is based on an estimate.

Mr. ELMENDORF. I think within a few months one might see some positive numbers. As you noted, November has been actually revised to be a very small positive change in employment, so I think it is possible in a few months.

Mr. BECERRA. And so there are some breaks in the cloud, reasons to be hopeful. Obviously if you are an American who has lost a job, you are not going to be hopeful until you have something in front of you. But given the numbers, the acronyms that we use up here, that economists use, GDP, interest rates, really we can start talking pretty positively about jobs, J-O-B, jobs in the future if we can continue in the right direction and get us out of that ditch, brake that train that was going fast downward, and start to see the economy, which has its own locomotion despite what—apart from what any Congress does or any President does, and just let the engine of our business community, our business men and women and the hard work and productivity of our American workers take hold?

Mr. ELMENDORF. We think the direction is for improvement. The concerns that I have expressed, and I think they are shared by many analysts, are that the pace of improvement may be slow enough that many people who will be looking for work will still be looking for work for some time. But the direction, certainly to us, seems to be positive at this point.

Mr. BECERRA. Can I have chart 8 as my last chart, and I will conclude with this. To me, there is reason for us to try to do whatever we can policywise to try to move us in the right direction. The last thing we need to do is bicker over what happened in the past. We need to remember what happened in the past; it informs what we do into the future. And certainly if that train hadn't been moving at 50 miles an hour with 150 cars on it, it wouldn't have taken a mile and a half to brake that downfall into that economic ditch that we were on.



But it is important for us to be fiscally responsible as we make policies for the economy and for Americans who wish to work.

When you inherit a $1.2 trillion deficit, that is what President Barack Obama received when he got the keys to the White House, when you are sworn in in January 2009 and are told that 741,000 Americans will lose their job or have lost their job in that month of January 2009, when Americans saw $2.7 trillion of their retirement savings erased, when we saw the debt, national debt, more than double in 8 years, we really were talking about the great recession of the 21st century. And we are now trying to pull ourselves out of that ditch which is the great recession of the 21st century. Had we not had some of those safety net provisions in place that Franklin Delano Roosevelt helped institute, we might have been in a great recession or a great depression of the 21st century.

And so, Dr. Elmendorf, I think we are going to be looking for your wise counsel over the next several months as we try to formulate the next budget for 2011 for this country, and we look forward to working with you. I appreciate your patience in responding to some of my questions.

And I see that the gentleman from Virginia Mr. Connolly is here, and so I will turn to him for his questions.

Mr. ELMENDORF. Thank you, Congressman.

Mr. CONNOLLY. Thank you, Mr. Chairman.

And sorry I am late, Mr. Elmendorf. I was at the Oversight and Government Reform Committee hearing listening to Secretary Geithner, and you should be glad you are here, not there.

I am going to ask just a series of questions real quickly, if I can. First of all, I worked in the Senate from 1979 to 1989 for a committee, and those were the Gramm-Rudman-Hollings days because we were so concerned about the growing debt. In retrospect, in your opinion, is there empirical evidence that Gramm-Rudman-Hollings ultimately led to a balanced budget?

Mr. ELMENDORF. I actually did a little work on that, Congressman, when I was a researcher in economics. I think the evidence is mixed. I mean, I think there is a—as you know, of course, the particular numerical targets that were chosen proved to be unreachable as a political matter. So the particular targets, not just the first version, but the second version, were not actually adhered to.

On the other hand, I think many analysts would say that that experience did focus people's attention on the issue. It kept it on the front burner of the political discussion. In the end the larger steps were taken in 1990 and 1993 and later. But I wouldn't want to—but I do think most analysts would say there was value in focusing attention on the issue even though it wasn't followed exactly.

Mr. CONNOLLY. PAYGO was adopted around, I think, 1998, PAYGO legislation, and allowed to lapse in 2002.

Mr. ELMENDORF. The original PAYGO legislation was adopted as part of the 1990 budget agreement. And that, as I mentioned earlier, when you were interrogating Secretary Geithner, is viewed by analysts as having helped prevent fiscal actions that would have made the budget situation worse.

Mr. CONNOLLY. Well, let me ask the same question about PAYGO of you that I just asked about Gramm-Rudman-Hollings.

Is there empirical evidence that PAYGO, in fact, was efficacious, that it made a difference?

Mr. ELMENDORF. I think it is a judgment call. It is not quite a number you can look up or calculate, which would be the best kind of empirical evidence. But I think most people's assessment, and this is a position taken by a number of my predecessors of CBO Directors in testimony, is that it did help to restrain policy actions that might have worsened the deficit during the period when people were very focused on deficits. At the end of the 1990s, as the economy was booming and the deficits turned into surpluses, then those constraints were widely ignored. But during the period of concern and attention on that problem, most analysts believe that the PAYGO rules did help to restrain policy actions.

Mr. CONNOLLY. A bipartisan commission with some enforcement mechanism to make decisions or recommendations stick, do you think it could make a difference, and do you believe—I know this is dicey—do you believe this body has the—historically, looking at it from an historical point of view—the discipline to abide by it?

Mr. ELMENDORF. I really can't and shouldn't speculate on the actions that you and your colleagues would take, Congressman.

Mr. CONNOLLY. You are no fun at all, Mr. Elmendorf.

Mr. ELMENDORF. I am in other contexts, but I don't think hearings are quite the place to display that side of me. You know, I think having a commission does not avoid the need for difficult decisions that ultimately you and your colleagues will have to make. The question that—I think the crucial question is whether it creates an environment that encourages such decisions to be put before you and to be made.

Mr. CONNOLLY. And could such a commission again be efficacious in affecting positively the debt, the long-term debt, only focused on the spending side?

Mr. ELMENDORF. It is harder to make changes that—it is harder to fix this fundamental disconnect between the level of spending that we are becoming accustomed to and the level of taxes that we are paying if one focuses on only one piece of the budget, because the magnitude of the gap that we see ahead is so large that to close that through one piece of the budget alone would require very radical changes in that particular piece. But again, it is not our place to say whether—what the combination of changes should be, and there is no economic reason why one can't focus on one piece or another. I just think it is a common judgment that the changes that would be required in a particular piece alone would be very, very dramatic.

Mr. CONNOLLY. Now, we had a hearing here last week with a panel on the long-term debt and what to do about it. And three out of the four witnesses for sure felt you couldn't just do one side of the ledger and not the other; you had to do both if you were going to have any kind of meaningful reduction in the long-term debt.

I thank you so much, Mr. Elmendorf.

And thank you, Mr. Chairman, for your indulgence.

Mr. BECERRA. I thank the gentleman for his questions.

Dr. Elmendorf, you have been gracious as usual with the time. We appreciate that. We will look to you in the future for further testimony and guidance. We look forward to hearing from you. And unless you wish to add anything for the record, we will close this hearing.

Mr. ELMENDORF. Thank you very much, Congressman.

Mr. BECERRA. I am being reminded I want to make sure that we provide for any Members who were here or did not have an opportunity to attend who did wish to ask you some questions the opportunity to do so. So without objection, Members who did not have the opportunity to ask questions of Dr. Elmendorf will be given 7 days to submit questions for the record.

[Questions submitted by Mr. Langevin and their responses follow:]

QUESTIONS FOR THE RECORD SUBMITTED BY CONGRESSMAN LANGEVIN AND DIRECTOR ELMENDORF'S RESPONSES

Yesterday's CBO forecasts put our economic and fiscal challenges in clear focus. While our budget projections have improved slightly, we remain on an unsustainable fiscal path with a projected deficit of $1.3 trillion in 2010 and an exploding debt that could reach 67 percent of our total economic output by 2020. These figures aren't just unsustainable, they are completely unacceptable. We must chart a clear course forward to get out of this fiscal mess. And in order to do that, we need to how we got here so we do not repeat the same mistakes.

1. Many factors contributed to our current deficit. How much has the impact of the recession and the corresponding increased federal spending, like the Recovery Act, contributed to the current deficit compared to the enactment of previously unpaid federal policies, like the 2001 and 2003 tax cuts?

Response: The Joint Committee on Taxation estimates that the tax provisions enacted in 2001 and 2003 increased the cumulative deficit between 2002 and 2011 by more than $1.6 trillion (excluding the cost of additional borrowing). CBO estimates that the cost of American Recovery and Reinvestment Act of 2009 will total nearly $850 billion (excluding the cost of additional borrowing) over the period from 2009 to 2019. The effect of the recession on the budget has also reduced revenues (and increased outlays to a lesser extent) by several hundred billion dollars both last year and this year.

2. Unemployment remains high, especially in my home state of Rhode Island where it stands at 12.9 percent, and families everywhere are still feeling the effects of the recession. When does CBO estimate that the unemployment rate will start to come down?

Response: The unemployment rate, which peaked at 10.1 percent in October and averaged 10 percent during the fourth quarter of 2009, has now posted three consecutive months through March at 9.7 percent. This is somewhat lower than CBO's forecast, in its January outlook, that the unemployment rate would average slightly above 10 percent during the first half of 2010 before turning down in the second half of the year. CBO expects that the U.S. economy will continue to grow through 2010, but at a moderate pace. Employment growth has begun to follow the recovery in spending, but, with discouraged and other marginally attached workers returning to the labor force, CBO continues to expect that increased hiring is unlikely to drive the unemployment rate down appreciably until the second half of the year.

The household survey, from which the unemployment rate is calculated, displays considerable month-to-month sample volatility. Hence, while the reduction in the unemployment rate to 9.7 percent was welcome, it may have partly reflected statistical factors rather than a greater-than-expected improvement in underlying labor market conditions. The household measure of employment has nevertheless shown solid growth over the past four months, and some analysts believe that, despite its volatility, the household measure may be capturing a nascent upturn in hiring better than the more widely used payroll survey-based measure of employment. For the time being, CBO's view follows more closely the payroll data, which is telling a rather weaker story than the household survey. After correcting for adverse weather effects, for census hiring, and for the re-benchmarking of the survey, payroll growth in the first quarter of 2010 appears to have been in line with CBO's January forecast for a weak recovery in employment in the first half of the year.

The unemployment rate rose unusually fast during 2009 relative to the slowdown in economic activity as firms shed workers in the face of uncertainty about economic prospects faster than they have typically done before, resulting in unusually high productivity growth in 2009. Going forward, CBO expects the growth of employment to follow its traditional relationship with the growth of output. Based on a wide range of economic indicators, CBO still foresees slow growth in output and employment over the next few years compared with the recoveries from past deep recessions. It is the slow growth of spending that drives CBO's forecast of only a gradual improvement in the unemployment rate.

3. Given the current state of the economy, what are the potential negative consequences to implementing deficit reduction too rapidly?

Response: Following the financial panic, private spending in the economy fell sharply as consumer and firms had to—or chose to—reduce their borrowing and indebtedness. As spending collapsed, factories and businesses were shuttered and unemployment soared. While the state of both financial markets and the economy have since improved, and while a sharp turn in the inventory cycle boosted the growth of real output in the fourth quarter of 2009, CBO projects that the underlying growth of demand in the U.S. economy is significantly weaker than in recoveries from past deep recessions. The modest rebound projected for 2010 and the next couple of years reflects a number of factors: the private sector is still seeking to consolidate its balance sheets; moreover, with short-term interest rates already close to zero, the Federal Reserve's ability to stimulate private sector spending through interest rate reductions—and perhaps through other unconventional means of monetary policy—remains limited. In the current economic environment, expansionary fiscal policy—through both increased government spending and reduced taxation-has been contributing to the recovery in economic activity, though its contribution is set to fade in the second half of 2010 and on into 2011.

A sharp, immediate withdrawal of fiscal stimulus from the U.S. economy would likely weaken aggregate demand. With private spending still restrained, the output of goods and services in the economy would fall. Weaker employment growth and higher unemployment would likely follow, while inflation and interest rates would be held down.

CBO's forecast of real economic growth illustrates this concern, for it must incorporate the tightening of fiscal policy built into current law in 2011. Current law implies that a range of tax rates will rise at the end of 2010. In addition, increased tax payments will come due during 2011 on liabilities resulting from the end of temporary AMT relief in 2009. The resultant rise in tax revenues amounts to a sudden deficit reduction of about 3 percentage points of GDP, and this is built into CBO's projections. The result of these tax hikes is to slow the growth of real GDP in CBO's forecast slightly in 2010, by about 1.4 percentage points in 2011, with a partial rebound of 0.6 percentage points during 2012. In addition to the tax changes assumed in current law, various provisions of the American Recovery and Relief Act phase down between 2010 and 2011 CBO estimates that the phase-down of those measures between 2010 and 2011 will subtract somewhere in the range of 1 to 2 percentage points from the growth of real GDP.

Of course the deleterious long-term implications for the economy of larger deficits and debt remain. The consequences of higher deficits and debt will manifest themselves over time in terms of a lower capital stock, productivity, wages and living standards. The difficult challenge for policymakers is to steer the appropriate course between the consequences of weakening demand too fast today and the price to be paid tomorrow for higher debt and deficits.

4. How much savings could we achieve through a discretionary spending freeze over the next three years? Can we fix our budgetary problem by spending cuts alone; and if so, what amount of spending cuts would we have to achieve to bring the budget into balance over the next ten years?

Response: A freeze on discretionary spending could save nearly $80 billion over the next three years, relative to CBO's baseline (which assumes that current appropriations grow at the rate of inflation). The amount of spending cuts required to balance the budget depends on when those cuts start. Beginning them earlier in the period would generate more interest savings (and therefore require fewer programmatic reductions) than waiting until later in the decade. We would be happy to work with your staff if you have some scenarios that you would like to explore.

Mr. BECERRA. With that, Director Elmendorf, we appreciate your testimony, and we will close the hearing. So this committee now stands adjourned, and we will be looking forward to seeing you in the future.

[Whereupon, at 12:55 p.m., the committee was adjourned.]