THE CONGRESSIONAL BUDGET OFFICE'S BUDGET AND ECONOMIC OUTLOOK

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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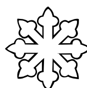

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THE CONGRESSIONAL BUDGET OFFICE'S BUDGET AND ECONOMIC OUTLOOK

THURSDAY, FEBRUARY 10, 2011

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

The committee met, pursuant to call, at 10:03 a.m., in room 210, Cannon House Office Building, Hon. Paul Ryan [chairman of the committee] presiding.

Present: Representatives Ryan of Wisconsin, Campbell, Calvert, Akin, McClintock, Stutzman, Ribble, Flores, Mulvaney, Young, Amash, Rokita, Van Hollen, Schwartz, Kaptur, Doggett, Blumenauer, McCollum, Honda, Ryan of Ohio, Wasserman Schultz, Castor, Tonko, and Bass.

Chairman RYAN. The hearing will come to order.

Thank you, Dr. Elmendorf, for coming before the committee today. It is nice to have you back and congratulations on your reappointment for a full term.

I first wanted to start off by saying how tough a job we know that the Congressional Budget Office and its employees have. We are going to work you pretty hard in the year to come. We appreciate the professionalism, the expertise that you have brought to the job.

Everybody brings to this job a background and a perspective and a point of view. And the best CBO Directors, whether it was Orszag or Holtz-Eakin, check it at the door, and you have done a very good job of doing that, of sticking down the middle of the fairway. And I just want to commend you for that.

We will have probably differences of opinions on methodology and things like that from time to time. But I enjoy the rigor of our debate, and I enjoy the fact that we can have a great exchange of ideas. And I also just want to simply start by saying I think it is great that you do more consulting with outside academics and outside forecasters because we don't have all the wisdom here, and it is important that you do that consultation. So I want to commend you for that and welcome you to a full 4-year term.

With that, I just got your report. We got this the other day. And it has deteriorated. Now our baseline is going in the wrong direction. And these problems that we have, let me first start off by saying it is not all the Democratic Party's fault or the Republican Party's fault. Both parties are responsible for where we are today. I would argue that in the most recent history I think our fiscal policy went in the wrong direction.

But finger pointing doesn't solve problems. Solutions solve problems. And we will have a difference of opinion on how to solve problems. And we do disagree with how to solve problems, but we don't disagree on where we want to go. We want people to have jobs in America. We want to have prosperity. We want to have an opportunity society. We want to leave our kids and our grandkids with a country that is better off, with a higher standard of living.

And what is interesting about this and previous reports that you have been giving us is, we know that without a shadow of doubt, we are giving the next generation a lower standard of living. What amazes me is when you do your long-run modelling, that your model actually ends up shutting down by the time our kids are in our age bracket because the CBO can't conceive a point in which the economy can continue because of the debt burdens that are being placed upon it.

So we have a moral imperative in this committee to get this right, to stop pointing fingers, to stop turning reforms into political weapons to be used in the next campaign and to actually buckle down and get this. Now, what is so important right now is the economy, is job creation, is prosperity.

Your latest report reminds us that between June of 2009, when the recession technically ended, and last December, payroll employment rose by a mere six one-hundredths of 1 percent, .06 percent. You compare that to the same period of time following past recessions, during those recoveries, employment rose by an average of 4.4 percent.

Unemployment is too high because job growth is too low. And job growth is too low because, in my opinion, contrary to conventional wisdom here in Washington, we cannot tax, borrow and spend our way to a prosperous future. The deficit is $1.5 trillion. The publicly held debt is up to 69 percent of GDP. It was at 40 percent by the end of 2008. And if you take a look at the alternative fiscal scenario, which I believe and most people would argue is the more accurate reading of where we are headed, it is down right scary.

And so we believe that the prosperity plan is real spending controls, spending cuts and reforms along with pro-growth economic policies for job creation. We can't create jobs in Washington. That is what the private sector does. And if we try to borrow and spend more money to create jobs in Washington, that ends up taking money from the private sector, propping up our debt, putting pressure on interest rates because current big deficits are nothing more than tomorrow's big tax increases. That produces more uncertainty for businesses.

So we just respectfully will probably disagree on how to create jobs, on how to get to prosperity, but let's just make sure that we all understand we want the same objective. We want our constituents to work. We want our kids and our grandkids to do better off. You are going to be overburdened with lots of requests. We really appreciate the way in which you respond with speed to all our requests, and we hope you do so as well with other members. But we have to get serious about this problem.

And hopefully we can do a fairly quick turnaround on the President's budget, which is a little late. That is because Jack Lew was appointed late. But hopefully you can get us a pretty good turn-

around on the President's budget. There is one more thing I would simply say is, we will be asking you to do some more runs on interest rate simulations, and on health care assumption simulations.

And with that, I just want to yield to my friend, the ranking member, Mr. Van Hollen.

[The prepared statement of Chairman Paul Ryan follows:]

PREPARED STATEMENT OF HON. PAUL RYAN, CHAIRMAN, COMMITTEE ON THE BUDGET

Thank you, Dr. Elmendorf, for coming before our Committee today to talk about the CBO's Budget and Economic Outlook.

Your testimony and this latest report remind us that, between June of 2009, when the recession technically ended, and last December, payroll employment rose by a mere 6 one hundredths of one percent (0.06 percent).

Compare that to the same period of time following past recessions. During those recoveries, employment rose by an average of 4.4 percent.

Unemployment is too high because job growth is too low. And job growth is too low because—contrary to the conventional wisdom here in Washington—we cannot tax, borrow and spend our way to a prosperous future.

One of the biggest threats to the economy is the rapid and seemingly relentless growth of government spending and debt. CBO is projecting a deficit of $1.5 trillion this year with the level of publicly-held debt rising to 69 percent of GDP by the end of the year, up from 40 percent at the end of 2008.

In a few short years, the CBO projects government spending to drive our debt to crisis levels, overwhelming the entire economy and drowning the next generation in red ink.

The President has asked us to raise the debt limit to accommodate all of this spending and borrowing. But the recent experience of Europe teaches us that we cannot keep making unaffordable promises without eventually hitting a real debt limit—a limit on our borrowing imposed by credit markets in a state of panic.

Endless borrowing is not a strategy. Spending restraint must come first. Federal Reserve Chairman Bernanke counseled us yesterday that the Congress needs to begin taking credible steps to reduce our looming longer-term structural budget deficits in order to grow the economy today.

We must restore the foundations of economic growth—low taxes, reasonable regulations, sound money, and spending restraint. We must apply our timeless principles to the challenges of the day.

If we act soon, and if we act responsibly, we can gradually phase in reforms to our major entitlement programs to save them from bankruptcy and ensure that people in and near retirement will be protected.

Federal health care spending is at the heart of our budget problems. Some have suggested that I am critical of CBO for its budget score of the new health care legislation. That is not correct.

The nonpartisan professionals at CBO must score the legislative language that is put in front of them.

This is not in any way a dispute with CBO. It is a dispute with the authors of the new health care law—and with their use of budget gimmicks, deceptive accounting, and highly dubious offsets.

We cannot begin to meet our fiscal challenges unless we have an honest debate about health care costs. As Chairman Bernanke reminded us yesterday, federal health care spending is driving our unsustainable deficits and debt, and the new law has done nothing to significantly reduce the strain that exploding health care costs are putting on the nation's finances.

Hiding spending to justify the creation of a new unaffordable entitlement doesn't get us any closer to solving the problem. We need to advance fiscally responsible, patient-centered reforms that actually reduce costs and expand coverage.

I look forward to your testimony today, Dr. Elmendorf. I hope we can learn more today about the budget and economic outlook and begin to put in place policies that lead to a permanent increase in jobs and put America on path of a more prosperous future.

With that, I will yield to Ranking Member Van Hollen for an opening statement.

Mr. VAN HOLLEN. Thank you, Chairman Ryan.

And I want to join my friend and colleague Paul Ryan in congratulating you, Dr. Elmendorf, on being reappointed.

As the chairman indicated, there are some times we like the CBO numbers and projections on one side or the other, sometimes we don't. But the reality is I think we agree that you and your team have been an incredibly professional organization. You call them as you see them. And I do believe, and I think we would agree on this, that when it comes to the budget process here in Congress, at the end of the day, we have to have some common measure of where we are on these different indicators and that if we were to throw out the CBO numbers, whether we sometimes agree with them or not, it would be a recipe for budget and fiscal chaos.

Let me just talk about some of those numbers because, as the chairman indicated, we probably do have different perspectives on how exactly we got here, but I think we do share a common interest—I know we share a common interest in trying to find a way out towards a fiscally sustainable future for this country.

But I do think it is important in light of the projections you have got just to remind the members of the committee that 2 years ago, the economy was in free fall. I mean, that is what the facts state. We were losing—we were at a negative 6 percent growth rate, losing 700,000 jobs a month. Yesterday in his testimony, Dr. Bernanke indicated that a combination of factors, including the recovery bill, actions by the Federal Reserve and efforts to rescue the financial system helped prevent a second great depression.

And your own CBO numbers confirm that the Recovery Act was a key ingredient in stopping the free fall and was responsible by your numbers of creating or saving between 1.3 and 3.4 million jobs. I think we all recognize that despite the fact that the economy has stabilized somewhat, the fact that millions of Americans remain out of work is absolutely unacceptable.

And what this report makes clear is that we do have to work together on a bipartisan basis to put our country on a fiscally sustainable path. I believe that the President's bipartisan commission that the chairman and others served on provided a lot of ideas that we should discuss and debate within this committee. They deserve a full vetting, and I would point out that the commission recognized the balance between acting now on a long-term plan and the dangers and risks of taking immediate deep cuts and the impact that could have on the economy and back—they said and I quote, in order to avoid shocking the fragile economy, the commission recommends waiting until 2012 to begin acting programmatic and spending cuts. We are going to have that debate.

And I think we should also recognize, and we do, that focusing on just one sliver of the budget, domestic discretionary cuts, will not get us out of this hole. That is very clear from your report, and we are going to have to look at all of the components of this problem.

And I hope that we will all come to the table with a sense of seriousness that we do need to look at the full picture going forward.

Let me just end with this because it has been much discussed in the news lately. We are coming up upon some key decision points. We have to extend the CR. And then, of course, there is the debt ceiling limit. I think it was very clear from the testimony of Dr. Bernanke yesterday that we should not be playing political games

with the full faith and credit of the United States, that we should not be, in his words, using that as a, quote, bargaining chip, that that would risk putting the economy in a total tailspin and putting even more Americans out of work.

With that, Mr. Chairman, thank you very much.

[The prepared statement of Chris Van Hollen follows:]

PREPARED STATEMENT OF HON. CHRIS VAN HOLLEN, RANKING MINORITY MEMBER, COMMITTEE ON THE BUDGET

Thank you, Dr. Elmendorf, for joining us today to discuss CBO's latest economic and budget projections that highlight the very real fiscal challenges we face.

Before we begin today's discussion on the CBO's outlook, it's important to remember the economic situation that President Obama confronted when he took office in 2009. Two years ago, we were losing jobs at the rate of over 700,000 a month. We have now had a year of continuous private sector job gains, totaling nearly 1.3 million jobs in 2010.

Yesterday, Federal Reserve Chairman Ben Bernanke testified that President Obama's American Recovery and Reinvestment Act, as well as measures taken to prevent the collapse of the financial sector and actions by the Federal Reserve, helped save the economy from a total meltdown.

CBO's own analysis confirms that the Recovery Act was a key ingredient in stopping the free fall, and that the legislation was responsible for saving and creating between 1.3 and 3.4 million jobs. But despite these gains, millions of Americans remain out of work and the unemployment rate is unacceptably high—it is clear there is more work to be done.

With that in mind, we're here today to talk about the CBO's Budget and Economic Outlook. This report makes it clear that Democrats and Republicans must work together now to put our nation on a fiscally sustainable path, and we stand ready to do that. The President's Bipartisan Fiscal Commission, which was charged with reducing the deficit, has put many important ideas on the table that we should review. One thing is clear—a strong economy is essential to both putting more Americans back to work and reducing our deficits. That is why the Commission said that 'in order to avoid shocking the fragile economy, the Commission recommends waiting until 2012 to begin enacting programmatic spending cuts.'

Immediate, deep cuts will not create a single job. A broad range of economists, including Mark Zandi, have determined that such cuts will actually hurt job growth. Additionally, Chairman Bernanke stressed that the most important thing we can do as a country is to put together a credible, long-term plan for fiscal sustainability, rather than focus on deep cuts in domestic discretionary spending over the next eight months. This long-term plan should include a discussion on reforming the tax system to make it more efficient—but we should not be extending unpaid-for tax cuts for the wealthiest 2 percent of Americans beyond 2012.

Unfortunately, during its first 30 days, the new Republican majority has passed measures that fly in the face of promises to tackle the deficit. First came the vote to get rid of the responsible House pay-as-you-go rule and replace it with a one sided rule that pretends that tax cuts for the wealthy don't add to the deficit. Next came the vote to eliminate important patient protections by repealing the health care reform bill and add a staggering $1.3 trillion to the national debt—as estimated by CBO—over the next 20 years. Just yesterday we saw a whole new budget gimmick on the House floor in an effort to eliminate funds that don't even exist—not surprisingly, CBO indicated that it wouldn't save the taxpayer one dime. And now there is talk of gambling with the full faith and credit of the United States government, which Chairman Bernanke yesterday indicated would lead to economic chaos.

So, Mr. Chairman, we welcome a serious debate about developing a credible, long-term deficit reduction plan that reflects our national values and priorities. We hope that our colleagues on the other side of the aisle will join us in a robust discussion on the best way to move our nation forward.

Chairman RYAN. Dr. Elmendorf, the floor is yours.

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

Mr. ELMENDORF. Thank you.

Mr. Chairman and Congressman Van Hollen, I want to start by saying I am honored and delighted to have the opportunity to stay

at CBO for 4 more years. And I appreciate both of your support in that.

And on behalf of myself and all of my colleagues, I want to say to you and all the members of the committee that we look forward to working with you, providing the information, analysis on the country's economic and budgetary challenges that would help you in wrestling with those challenges.

Indeed, the United States faces daunting economic and budgetary challenges. The economy, as you know, has struggled to recover from the recent recession. The pace of growth and output has been anemic compared to that during most other recoveries. The unemployment rate has remained quite high. The Federal budget deficit and debt have surged in the past 2 years, owing to a combination of a severe drop in economic activity, the policies enacted in response to the financial crisis and recession, and an imbalance between spending and revenues that predated the recession.

Unfortunately, it is likely that a return to normal economic conditions will take years. And even after the economy is fully recovered, a return to sustainable budget conditions will require significant changes in tax and spending policies.

Let me discuss the economic outlook first and then turn to the budget outlook. CBO expects that production and employment will expand in the coming years, but only at a moderate pace, leaving the economy well below its potential for some time. We project that real GDP will increase about 3 percent this year and again next year, reflecting continued strong growth in business investment, improvements in both residential investment and net exports, and modest increases in consumer spending.

But we have a long way to go on the employment front.

Go to the first slide.

Payroll employment, which declined by nearly 9 million between the end of 2007 and early 2010, has recovered by just a shade over 1 million since then. The recovery in employment has been slowed not only by the slow growth in output, but also by structural changes in the labor market, such as a mismatch again the requirements of available jobs and the skills of job seekers.

We estimate that the economy will add roughly 2.5 million jobs per year over the 2011-2016 period, similar to the average pace during the late 1990s. But even so, we expect the unemployment rate, shown in the next slide, will be just above 9 percent in the fourth quarter of this year and still above 8 percent at the end of 2012. Only by 2016 in our forecast does the unemployment rate reach 5.25 percent, close to our estimate of the natural rate.

CBO projects that inflation will remain very low in 2011 and 2012, reflecting the large amount of unused resources in the economy. And it will average no more than 2 percent a year between 2013 and 2016.

Economic developments and the government's responses to them have, of course, had a big impact on the budget. The next slide shows we estimate that if current laws remain unchanged, the budget deficit this year, the third column of that table, will be close to $1.5 trillion or 9.8 percent of GDP. That will follow deficits of 10 percent and 8.9 percent of GDP in the past 2 years, representing the three largest deficits since 1945. As a result, debt

held by the public will probably jump from 40 percent of GDP by the end of fiscal year 2008 to nearly 70 percent at the end of this fiscal year in September.

If current laws remain unchanged as we assume for CBO's baseline projections, budget deficits would drop markedly over the next few years as a share of output. The next slide shows the deficits would average 3.6 percent of GDP between 2012 and 2021—that is the solid line—totaling nearly $7 trillion over the coming decade. As a result, the debt held by the public would keep rising, reaching 77 percent of GDP in 2021.

However, that projection is based on the assumption that spending and tax policies unfold as specified in current law. Consequently and as the chairman noted, it understates the budget deficits that would occur if many policies currently in place were continued rather than allowed to expire as scheduled in current law. For example, suppose instead that three major aspects of current policy were continued during the coming decade: First, that the higher 2011 exemption amount for the alternative minimum tax is extended and along with the AMT tax brackets is indexed for inflation; second, that the other major provisions in the recently enacted tax legislation that affected individual income taxes and gift taxes and estate taxes were extended rather than allowed to expire in January 2013; and third, that Medicare's payment rates for physician services were held constant rather than dropping sharply as scheduled at the end of the year under current law. All of those policies have recently been extended for 1 or 2 years. If they were extended permanently, deficits from 2012 through 2021 would average about 6 percent of GDP, the dashed line, rather than 3.5 percent under current law. And cumulative deficits over the decade would total nearly $12 trillion.

The next slide shows the debt held by the public in 2021 would, under that alternative, rise to almost 100 percent of GDP, the highest levels since 1946.

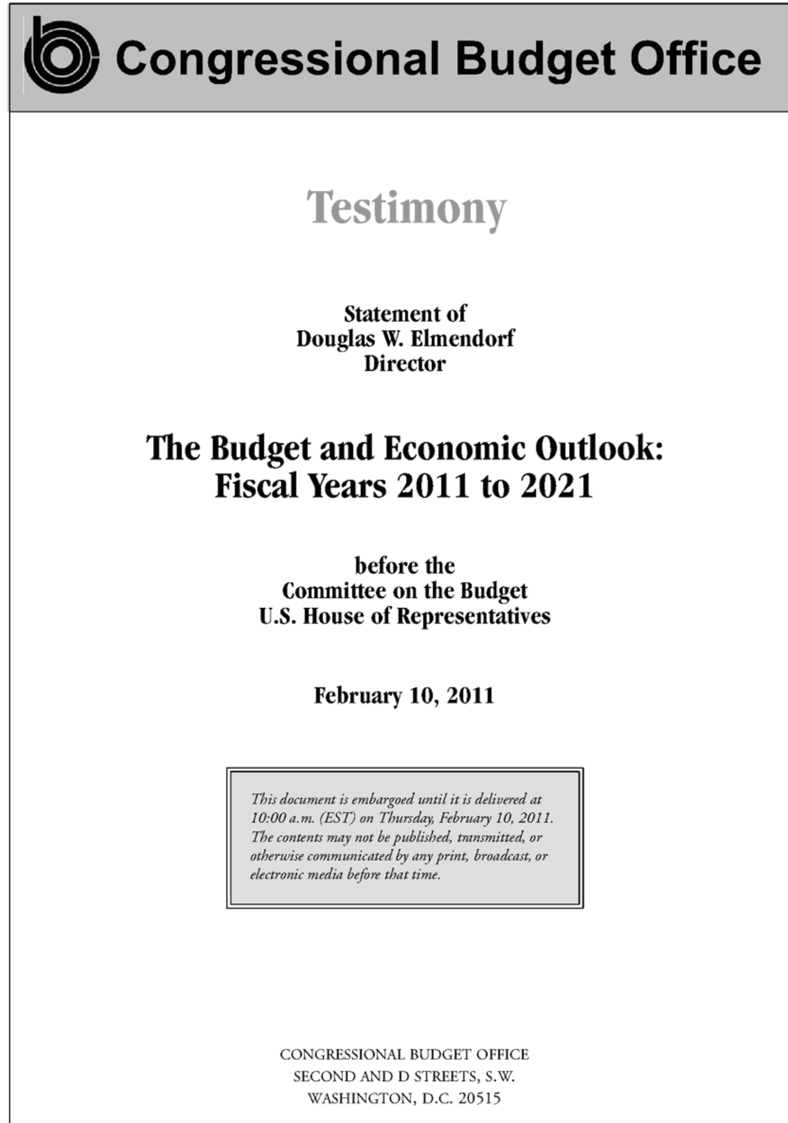
Beyond the 10-year projection period, further increases in Federal debt relative to the Nation's output almost certainly lie ahead if current policies remain in place. Spending on Social Security and the government's major mandatory health care programs, including Medicare, Medicaid, the children's health insurance program and insurance subsidies to be provided through exchanges, will increase from roughly 10 percent of GDP to about 16 percent over the next 25 years.

To prevent debt from becoming unsupportable, the Congress will have to substantially restrain the growth of spending, raise revenues significantly above their historical share of GDP, or pursue some combination of those two approaches. The longer the necessary adjustments are delayed, the greater will be the negative consequences of the mounting debt, the more uncertain individuals and businesses will be about future government policies, and the more drastic the ultimate policy changes will need to be.

However, changes of the magnitude that will ultimately be required could be disruptive. Therefore, Congress may wish to implement them gradually so as to avoid a sudden negative impact on the economy, particularly as it recovers from the severe recession and so as to give families, businesses and State and local govern-

ments time to plan and adjust. Allowing for such gradual implementation would mean, however, that remedying the Nation's fiscal imbalance would take longer and therefore that major policy changes would need to be enacted sooner to limit the further increase in Federal debt. Thank you. I am happy to take your questions.

[The prepared statement of Douglas W. Elmendorf follows:]



Congressional Budget Office

Testimony

Statement of
Douglas W. Elmendorf
Director

The Budget and Economic Outlook:
Fiscal Years 2011 to 2021

before the
Committee on the Budget
U.S. House of Representatives

February 10, 2011

This document is embargoed until it is delivered at 10:00 a.m. (EST) on Thursday, February 10, 2011. The contents may not be published, transmitted, or otherwise communicated by any print, broadcast, or electronic media before that time.

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Chairman Ryan, Congressman Van Hollen, 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 2011 through 2021. Those estimates were released a few weeks ago in the report titled *The Budget and Economic Outlook: Fiscal Years 2011 to 2021*.

The United States faces daunting economic and budgetary challenges. The economy has struggled to recover from the recent recession, which was triggered by a large decline in house prices and a financial crisis—events unlike anything this country has seen since the Great Depression. During the recovery, the pace of growth in the nation's output has been anemic compared with that during most other recoveries since World War II, and the unemployment rate has remained quite high.

For the federal government, the sharply lower revenues and elevated spending deriving from the financial turmoil and severe drop in economic activity—combined with the costs of various policies implemented in response to those conditions and an imbalance between revenues and spending that predated the recession—have caused budget deficits to surge in the past two years. The deficits of $1.4 trillion in 2009 and $1.3 trillion in 2010 are, when measured as a share of gross domestic product (GDP), the largest since 1945—representing 10.0 percent and 8.9 percent of the nation's output, respectively.

For 2011, the Congressional Budget Office projects that if current laws remain unchanged, the federal budget will show a deficit of close to $1.5 trillion, or 9.8 percent of GDP (see Table 1). The deficits in CBO's baseline projections drop markedly over the next few years as a share of output and average 3.1 percent of GDP from 2014 to 2021. Those projections, however, are based on the assumption that tax and spending policies unfold as specified in current law. Consequently, they understate the budget deficits that would occur if many policies currently in place were continued, rather than allowed to expire as scheduled under current law.

The Economic Outlook

Although recent actions by U.S. policymakers should help support further gains in real (inflation-adjusted) GDP in 2011, production and employment are likely to stay well below the economy's potential for a number of years. CBO expects that economic growth will remain moderate this year and next. As measured by the change from the fourth quarter of the previous year, real GDP is projected to increase by 3.1 percent this year and by 2.8 percent next year (see Table 2). That forecast reflects CBO's expectation of continued strong growth in business investment, improvements in both residential investment and net exports, and modest increases in consumer spending. It also includes the impact of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (referred to in this report as the 2010 tax act), enacted in December, which provides a short-term boost to the economy by reducing some taxes, extending unemployment benefits, and delaying an increase in taxes that would otherwise have occurred in 2011. CBO projects that inflation will remain very low in 2011 and 2012, reflecting the large amount of unused resources in the economy, and will average no more than 2.0 percent a year between 2013 and 2016.

The recovery in employment has been slowed not only by the moderate growth in output in the past year and a half but also by structural changes in the labor market, such as a mismatch between the requirements of available jobs and the skills of job seekers, that have hindered the reemployment of workers who have lost their job. Payroll employment, which declined by 7.3 million during the recent recession, gained a mere 70,000 jobs (or 0.06 percent), on net, between June 2009 and December 2010. (By contrast, in the first 18 months of past recoveries, employment rose by an average of 4.4 percent.) Consequently, the rate of unemployment has fallen by only a small amount: After climbing to 10.1 percent of the labor force during 2009, the unemployment rate declined only to 9.4 percent by December 2010. Other measures of labor market conditions suggest even more slack than does the unemployment rate. For example, almost 9 million workers who have wanted full-time work in the past two years have been employed only part time.

As the recovery continues, the economy will add roughly 2.5 million jobs per year over the 2011–2016 period,

Table 1.

CBO's Baseline Budget Outlook

	Actual,												Total	
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2016	2012-2021
							In Billions of Dollars							
Total Revenues	2,162	2,228	2,555	3,090	3,442	3,651	3,832	4,075	4,275	4,489	4,712	4,963	16,570	39,084
Total Outlays	3,456	3,708	3,655	3,794	3,975	4,202	4,491	4,691	4,885	5,185	5,451	5,726	20,117	46,055
Total Deficit (-) or Surplus	**-1,294**	**-1,480**	**-1,100**	**-704**	**-533**	**-551**	**-659**	**-617**	**-610**	**-696**	**-739**	**-763**	**-3,547**	**-6,971**
On-Budget	-1,371	-1,548	-1,186	-792	-621	-641	-752	-706	-693	-768	-798	-808	-3,992	-7,765
Off-Budget[a]	77	68	86	88	87	90	94	90	82	73	59	45	445	794
Debt Held by the Public at the End of the Year	9,018	10,430	11,598	12,386	12,996	13,625	14,358	15,064	15,767	16,557	17,392	18,253	n.a.	n.a.
							As a Percentage of GDP							
Total Revenues	14.9	14.8	16.3	18.8	19.9	20.1	20.0	20.3	20.4	20.5	20.7	20.8	19.1	19.9
Total Outlays	23.8	24.7	23.3	23.1	23.0	23.1	23.5	23.4	23.3	23.7	23.9	24.0	23.2	23.5
Total Deficit	**-8.9**	**-9.8**	**-7.0**	**-4.3**	**-3.1**	**-3.0**	**-3.4**	**-3.1**	**-2.9**	**-3.2**	**-3.2**	**-3.2**	**-4.1**	**-3.6**
Debt Held by the Public at the End of the Year	62.1	69.4	73.9	75.5	75.3	74.9	75.0	75.2	75.3	75.8	76.2	76.7	n.a.	n.a.

Source: Congressional Budget Office.

Note: n.a. = not applicable.

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

CBO estimates. However, even with significant increases in the number of jobs, a substantial reduction in the unemployment rate will take some time. CBO projects that the unemployment rate will gradually fall in the near term, to 9.2 percent in the fourth quarter of 2011, 8.2 percent in the fourth quarter of 2012, and 7.4 percent at the end of 2013. Only by 2016, in CBO's forecast, does it reach 5.3 percent, close to the agency's estimate of the natural rate of unemployment (the rate of unemployment arising from all sources except fluctuations in aggregate demand, which CBO now estimates to be 5.2 percent).

For the period beyond 2016, CBO's economic projections are based on trends in the factors that underlie potential output, including the labor force, capital accumulation, and productivity. The projections therefore do not explicitly incorporate fluctuations resulting from the business cycle. In CBO's projections, growth of real GDP averages 2.4 percent annually from 2017 to 2021, a pace that matches the growth of potential GDP over those years. The unemployment rate averages 5.2 percent in that same period.

The Budget Outlook

The recovery now under way might be expected to lessen the budget imbalance in 2011 by increasing tax revenues and decreasing spending for certain income-support programs, such as unemployment compensation. However, revenue growth will be restrained by the slow and tentative pace of the recovery and by the 2010 tax act.

Moreover, outlays for many programs are projected to continue to grow and more than offset the decreases in spending (for unemployment compensation, for example) yielded by improving economic conditions.

The resulting federal budget deficit of nearly $1.5 trillion projected for this year will equal 9.8 percent of GDP, a share that is nearly 1 percentage point higher than the shortfall recorded last year and almost equal to the deficit posted in 2009, which at 10.0 percent of GDP was the highest in nearly 65 years.

By CBO's estimates, federal revenues in 2011 will be $123 billion (or 6 percent) more than the total revenues recorded two years ago, in 2009. The continued slow

Table 2.

CBO's Economic Projections for Calendar Years 2010 to 2021

	Estimated, 2010	Forecast 2011	Forecast 2012	Projected Annual Average 2013–2016	Projected Annual Average 2017–2021
	Fourth Quarter to Fourth Quarter (Percentage change)				
Real GDP	2.5	3.1	2.8	3.4	2.4
PCE Price Index	1.4	1.2	1.3	1.7	2.0
Core PCE Price Index[a]	1.0	1.0	1.2	1.6	2.0
Consumer Price Index[b]	1.2 [c]	1.3	1.3	2.0	2.3
Core Consumer Price Index[a]	0.6 [c]	0.9	1.2	1.9	2.2
	Fourth Quarter Level (Percent)				
Unemployment Rate	9.6 [c]	9.2	8.2	5.3 [d]	5.2 [e]
	Calendar Year Average				
Interest Rates (Percent)					
Three-month Treasury bill rate	0.1 [c]	0.3	1.1	3.6	4.4
Ten-year Treasury note rate	3.2 [c]	3.4	3.8	4.7	5.4
Unemployment Rate (Percent)	9.6 [c]	9.4	8.4	6.4	5.2
Nominal GDP (Percentage change)	3.8	3.7	4.4	5.1	4.4

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

Notes: Data for the fourth quarter of 2010 were not available when CBO's forecast was completed in early December. Numbers for gross domestic product (GDP) in the table for 2010 are therefore based on CBO's estimates made in early December. More recent estimates from other forecasters, based on additional data, suggest that growth of nominal and real (inflation-adjusted) GDP in the fourth quarter was higher than CBO estimated.

PCE = personal consumption expenditures.

a. Excludes prices for food and energy.

b. The consumer price index for all urban consumers.

c. Actual value for 2010.

d. Value for 2016.

e. Value for 2021.

improvement in economic conditions is anticipated to boost revenues from individual income taxes, corporate taxes, and other sources by nearly $200 billion between those two years; however, revenues from social insurance taxes are projected to decline by more than $70 billion relative to their level two years ago, mostly as a result of a one-year reduction in payroll taxes included in the 2010 tax act.

Spending, for the most part, has been growing faster than revenues. Programs related to the federal government's response to the problems in the housing and financial markets are an exception; outlays recorded for the Troubled Asset Relief Program (TARP), for example, will decrease by $176 billion from 2009 to 2011, CBO projects.[1] But if current laws remain unchanged, federal outlays other than those for the TARP are projected to be $366 billion (or 11 percent) higher in 2011 than they were in 2009.

1. The Administration recorded outlays of $151 billion for the TARP in 2009, which reflected its estimate of the cost of the actions that had been undertaken by the Treasury. Because the financial system stabilized and many institutions repaid the assistance provided by the TARP earlier than expected, the Administration—following the standard procedures for federal credit programs—reduced the previously recorded cost by posting a large *negative* outlay (that is, a reduction in spending) in 2010. The program will again reduce the deficit in 2011, CBO estimates—showing negative outlays of $25 billion, mostly reflecting a further adjustment to the estimated cost recorded in 2009.

According to CBO's projections, mandatory spending excluding outlays for the TARP will increase by $191 billion (or 10 percent) between 2009 and 2011.[2] Significant growth in many areas—in particular, for Social Security, Medicare, and Medicaid—is expected to be offset only partially by reductions in outlays for other programs, primarily for Fannie Mae, Freddie Mac, and deposit insurance. Discretionary spending will increase by an estimated $137 billion over the two-year period; about one-third of that increase stems from funding provided by the American Recovery and Reinvestment Act of 2009 (ARRA). In addition, outlays for net interest will rise by an estimated $38 billion from 2009 to 2011, mostly because of substantial increases in borrowing.

Under current law, CBO projects, budget deficits will drop markedly over the next few years—to $1.1 trillion in 2012, $704 billion in 2013, and $533 billion in 2014. Relative to the size of the economy, those deficits represent 7.0 percent of GDP in 2012, 4.3 percent in 2013, and 3.1 percent in 2014. From 2015 through 2021, the deficits in the baseline projections range from 2.9 percent to 3.4 percent of GDP.

The deficits that will accumulate under current law will push federal debt held by the public to significantly higher levels. Just two years ago, debt held by the public was less than $6 trillion, or about 40 percent of GDP; at the end of fiscal year 2010, such debt was roughly $9 trillion, or 62 percent of GDP, and by the end of 2021, it is projected to climb to $18 trillion, or 77 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 over the next decade. CBO projects that the government's annual spending on net interest will more than double between 2011 and 2021 as a share of GDP, increasing from 1.5 percent to 3.3 percent.

CBO's baseline projections are not intended to be a forecast of future budgetary outcomes; rather, they serve as a neutral benchmark that legislators and others can use to assess the potential effects of policy decisions. Consequently, they incorporate the assumption that current laws governing taxes and spending will remain unchanged. In particular, the baseline projections in this report are based on the following assumptions:

- Sharp reductions in Medicare's payment rates for physicians' services take effect as scheduled at the end of 2011;
- Extensions of unemployment compensation, the one-year reduction in the payroll tax, and the two-year extension of provisions designed to limit the reach of the alternative minimum tax all expire as scheduled at the end of 2011;
- Other provisions of the 2010 tax act, including extensions of lower tax rates and expanded credits and deductions originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001, the Jobs and Growth Tax Relief Reconciliation Act of 2003, and ARRA, expire as scheduled at the end of 2012; and
- Funding for discretionary spending increases with inflation rather than at the considerably faster pace seen over the dozen years leading up to the recent recession.

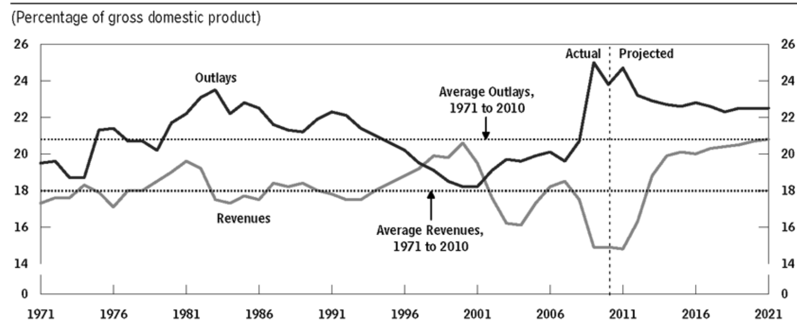
The projected deficits over the latter part of the coming decade are much smaller relative to GDP than is the current deficit, mostly because, under those assumptions and with a continuing economic expansion, revenues as a share of GDP are projected to rise steadily—from about 15 percent of GDP in 2011 to 21 percent by 2021 (see Figure 1).

As a result, the baseline projections understate the budget deficits that would arise if many policies currently in place were extended, rather than allowed to expire as scheduled under current law. For example, if most of the provisions in the 2010 tax act that were originally enacted in 2001, 2003, and 2009 or that modified estate and gift taxation were extended (rather than allowed to expire on December 31, 2012), and the alternative minimum tax was indexed for inflation, annual revenues would average about 18 percent of GDP through 2021 (which is equal to their 40-year average), rather than the 19.9 percent shown in CBO's baseline projections. If Medicare's payment rates for physicians' services were held constant as well, then deficits from 2012 through 2021 would average about 6 percent of GDP, compared with 3.6 percent in the baseline. By 2021, the budget deficit would be about double the baseline projection, and with cumulative deficits totaling nearly $12 trillion over the

2. Mandatory spending is governed by permanent law; in contrast, discretionary spending is controlled by annual appropriation acts.

Figure 1.
Total Revenues and Outlays

(Percentage of gross domestic product)



Source: Congressional Budget Office.

2012–2021 period, debt held by the public would reach 97 percent of GDP, the highest level since 1946.

Beyond the 10-year projection period, further increases in federal debt relative to the nation's output almost certainly lie ahead if current policies remain in place. The aging of the population and rising costs for health care will push federal spending as a percentage of GDP well above that in recent decades. Specifically, spending on the government's major mandatory health care programs—Medicare, Medicaid, the Children's Health Insurance Program, and health insurance subsidies to be provided through insurance exchanges—along with Social Security will increase from roughly 10 percent of GDP in 2011 to about 16 percent over the next 25 years.[3] If revenues stay close to their average share of GDP for the past 40 years, that rise in spending will lead to rapidly growing budget deficits and surging federal debt. To prevent debt from becoming unsupportable, policymakers will have to substantially restrain the growth of spending, raise revenues significantly above their historical share of GDP, or pursue some combination of those two approaches.

3. See Congressional Budget Office, *The Long-Term Budget Outlook* (June 2010, revised August 2010).

Figure 2-12. Possible Paths to Full Employment

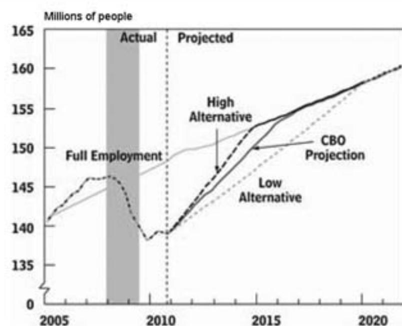
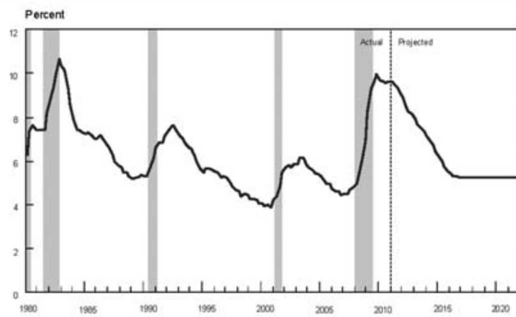
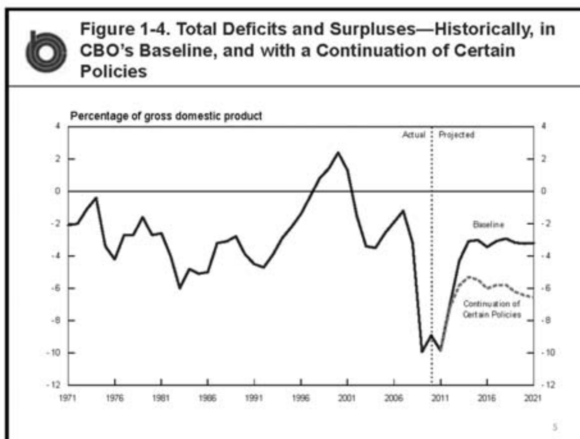


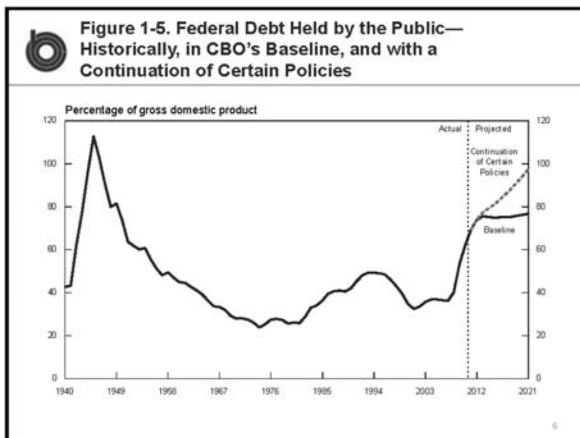
Figure 2-2. Unemployment Rate



Summary Table 1. CBO's Baseline Budget Outlook

	Actual, 2009	Actual, 2010	2011	2012	2013	2014	2021	Total, 2012–2021
				In Billions of Dollars				
Total Deficit	-1,413	-1,294	-1,480	-1,100	-704	-533	-763	-6,971
Debt Held by the Public	7,545	9,018	10,430	11,598	12,386	12,996	18,253	
				As a Percentage of GDP				
Total Deficit	-10.0	-8.9	-9.8	-7.0	-4.3	-3.1	-3.2	-3.6
Debt Held by the Public	53.5	62.1	69.4	73.9	75.5	75.3	76.7	





Complete Set of Figures

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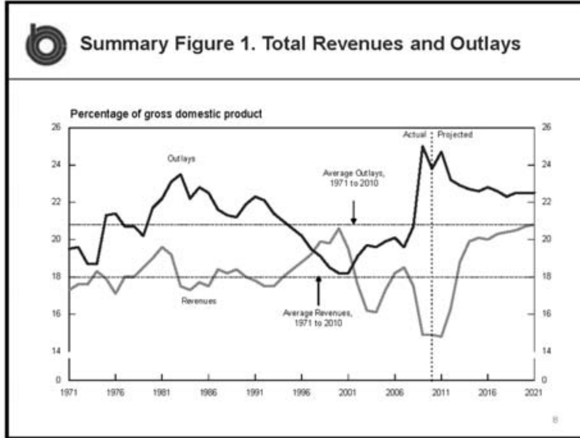

Summary Figure 1. Total Revenues and Outlays
Percentage of gross domestic product
Actual
Projected
Outlays
Average Outlays, 1971 to 2010
Revenues
Average Revenues, 1971 to 2010
8

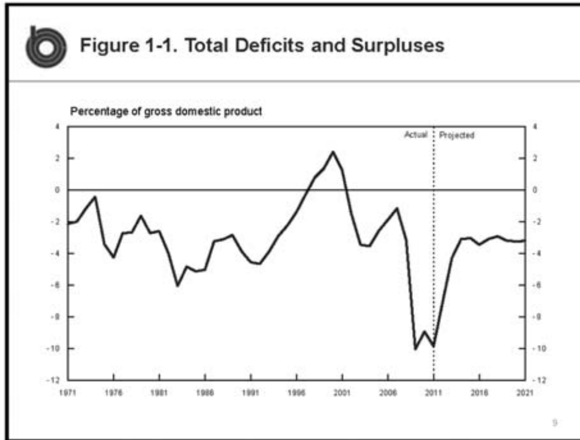


Figure 1-1. Total Deficits and Surpluses
Percentage of gross domestic product
Actual
Projected
9

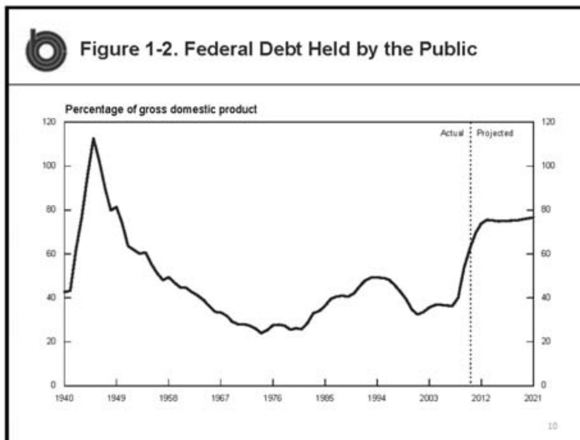


Figure 1-2. Federal Debt Held by the Public
Percentage of gross domestic product
Actual
Projected
10

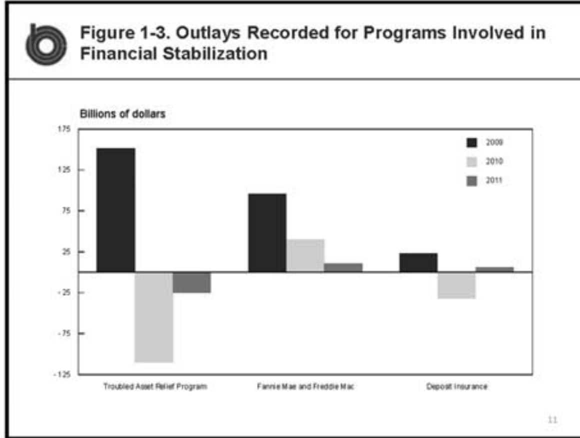


Figure 1-3. Outlays Recorded for Programs Involved in Financial Stabilization
Billions of dollars
2009
2010
2011
Troubled Asset Relief Program
Fannie Mae and Freddie Mac
Deposit Insurance
11

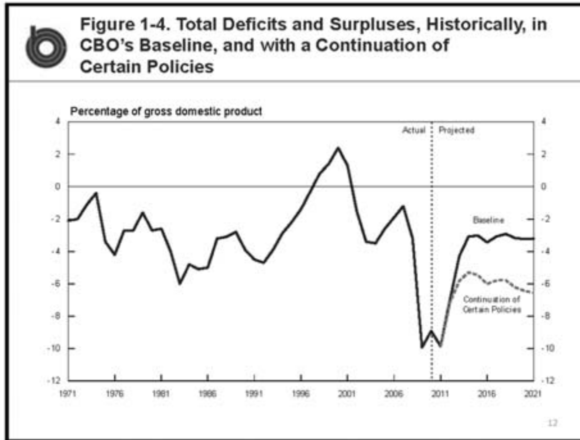


Figure 1-4. Total Deficits and Surpluses, Historically, in CBO's Baseline, and with a Continuation of Certain Policies
Percentage of gross domestic product
Actual
Projected
Baseline
Continuation of Certain Policies
1971
1976
1981
1986
1991
1996
2001
2006
2011
2016
2021
12

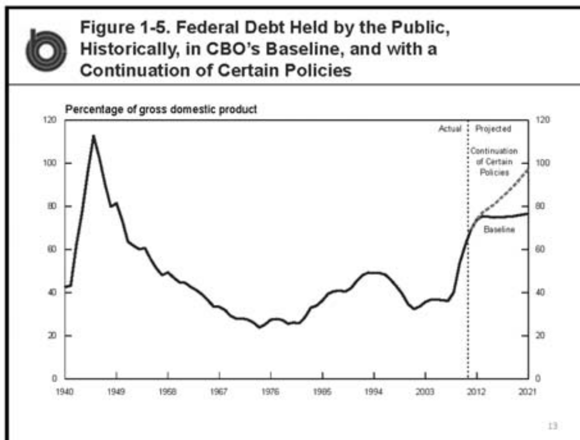


Figure 1-5. Federal Debt Held by the Public, Historically, in CBO's Baseline, and with a Continuation of Certain Policies
Percentage of gross domestic product
Actual
Projected
Continuation of Certain Policies
Baseline
1940
1949
1958
1967
1976
1985
1994
2003
2012
2021
13

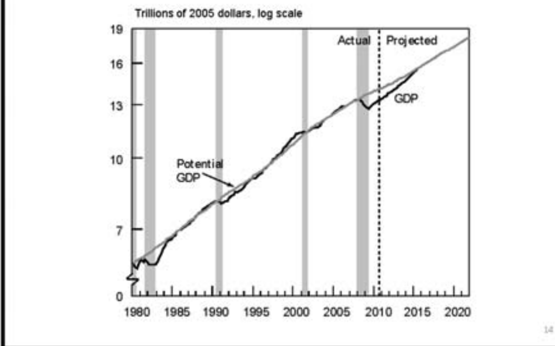


Figure 2-1. Real Gross Domestic Product
Trillions of 2005 dollars, log scale
19
16
13
10
7
0
Actual
Projected
GDP
Potential
GDP
1980
1985
1990
1995
2000
2005
2010
2015
2020
14

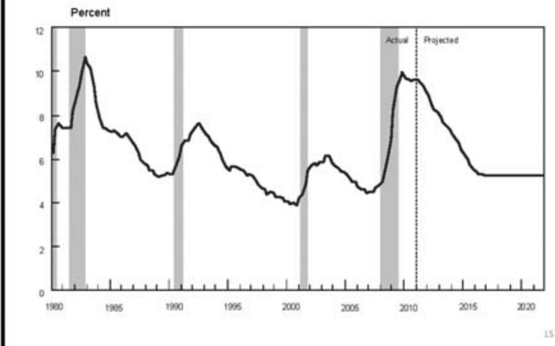


Figure 2-2. Unemployment Rate
Percent
12
10
8
6
4
2
0
Actual
Projected
1980
1985
1990
1995
2000
2005
2010
2015
2020
15

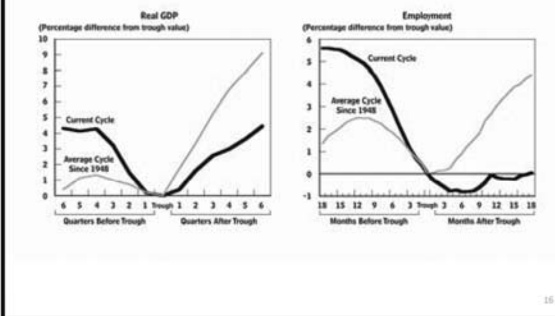


Figure 2-3. Recovery in Real Gross Domestic Product and Employment
Real GDP
(Percentage difference from trough value)
Current Cycle
Average Cycle
Since 1948
Quarters Before Trough
Quarters After Trough
Employment
(Percentage difference from trough value)
Current Cycle
Average Cycle
Since 1948
Months Before Trough
Months After Trough
16

Figure 2-4. Unemployed Workers per Job Opening

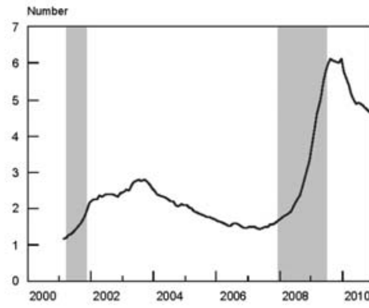
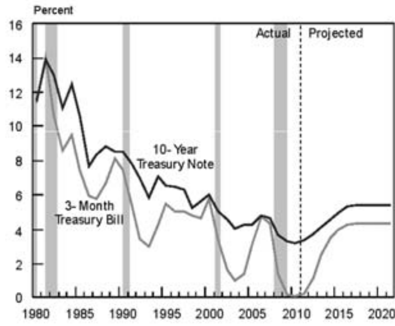


Figure 2-5. Net Lending by the Financial Sector

Figure 2-6. Household Net Worth

Figure 2-7. Interest Rates

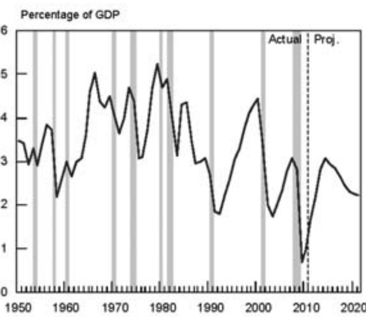


20

Figure 2-8. Vacant Housing Units

21

Figure 2-9. Net Business Fixed Investment



22

Figure 2-10. Exchange Value of the U.S. Dollar
Index, March 1973 = 100
130
120
110
100
90
80
0
1980
1985
1990
1995
2000
2005
2010
23

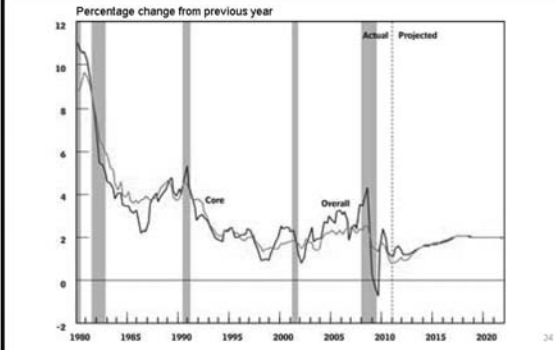


Figure 2-11. Inflation (updated for fourth quarter data)
Percentage change from previous year
Actual
Projected
Core
Overall
1980
1985
1990
1995
2000
2005
2010
2015
2020
24

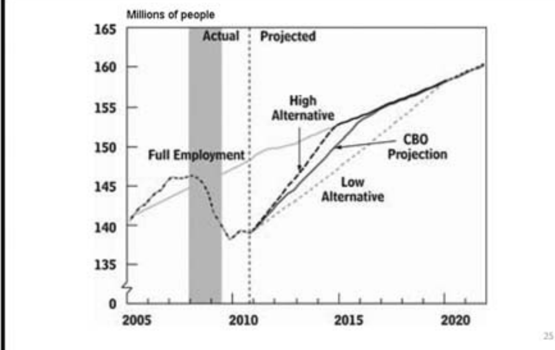


Figure 2-12. Possible Paths to Full Employment
Millions of people
165
160
155
150
145
140
135
0
Actual
Projected
High Alternative
Full Employment
CBO Projection
Low Alternative
2005
2010
2015
2020
25

Figure 2-13. People Who Have Lost Their Job

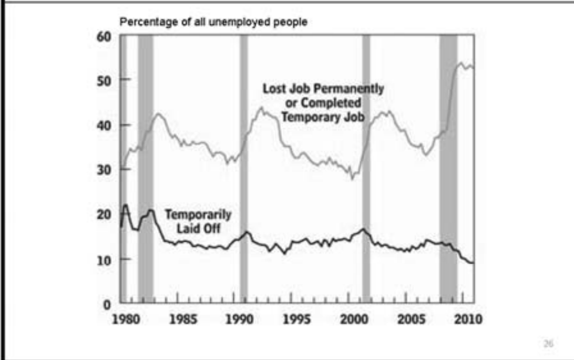


Figure 2-14. Current and August 2010 Forecasts of Real and Potential Gross Domestic Product

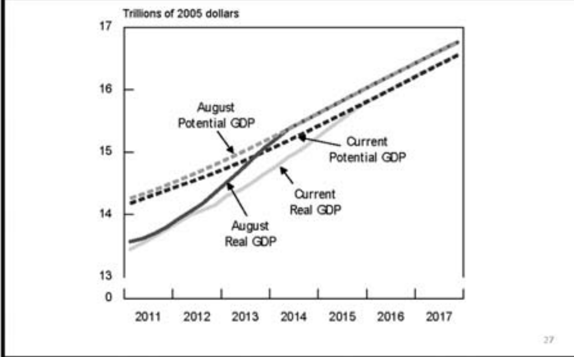


Figure 3-1. Outlays, by Category

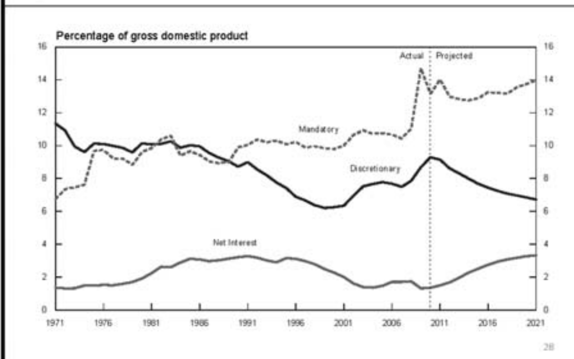
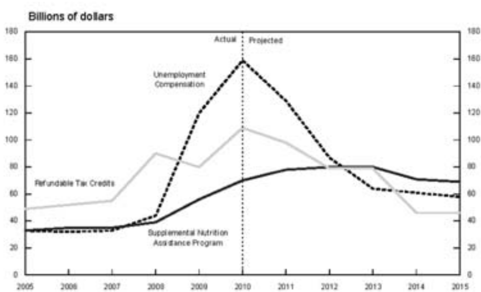
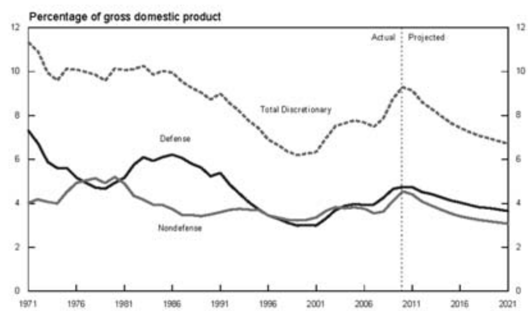


Figure 3-2. Outlays for Selected Income-Security Programs



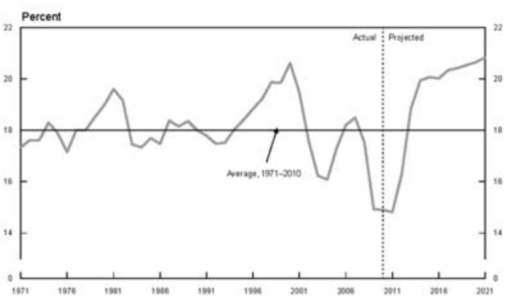
29

Figure 3-3. Defense, Nondefense, and Total Discretionary Spending



30

Figure 4-1. Total Revenues as a Share of Gross Domestic Product



31

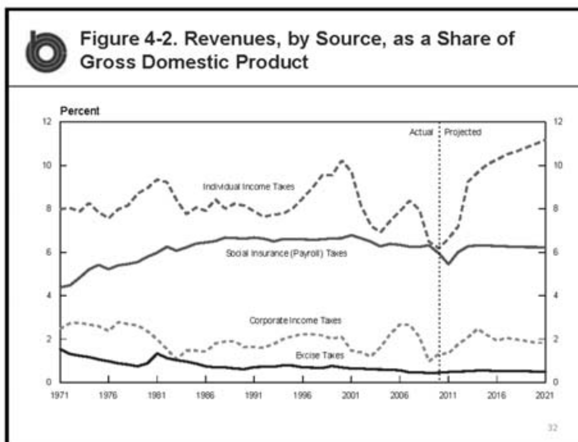
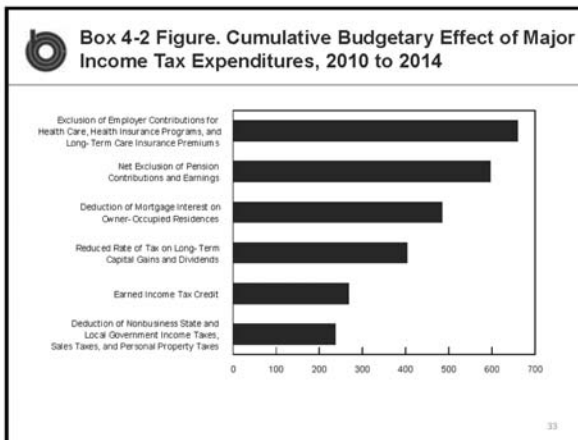


Figure 4-2. Revenues, by Source, as a Share of Gross Domestic Product
Percent
Actual
Projected
Individual Income Taxes
Social Insurance (Payroll) Taxes
Corporate Income Taxes
Excise Taxes
0
2
4
6
8
10
12
1971
1976
1981
1986
1991
1996
2001
2006
2011
2016
2021
32


Box 4-2 Figure. Cumulative Budgetary Effect of Major Income Tax Expenditures, 2010 to 2014
Exclusion of Employer Contributions for Health Care, Health Insurance Programs, and Long-Term Care Insurance Premiums
Net Exclusion of Pension Contributions and Earnings
Deduction of Mortgage Interest on Owner-Occupied Residences
Reduced Rate of Tax on Long-Term Capital Gains and Dividends
Earned Income Tax Credit
Deduction of Nonbusiness State and Local Government Income Taxes, Sales Taxes, and Personal Property Taxes
0
100
200
300
400
500
600
700
33

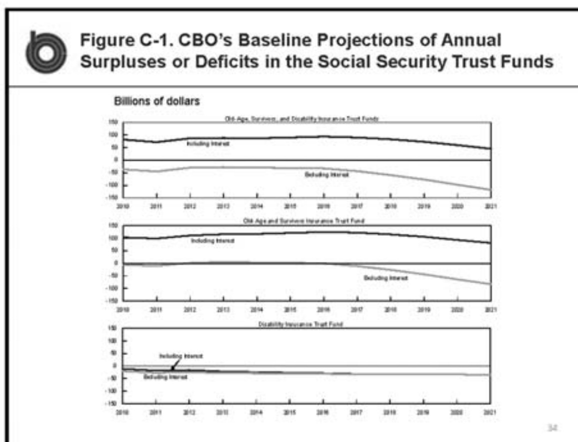


Figure C-1. CBO's Baseline Projections of Annual Surpluses or Deficits in the Social Security Trust Funds
Billions of dollars
34

Chairman RYAN. I thought you were going to go through the whole PowerPoint. I have about 40 pages here.

Mr. ELMENDORF. I should say all of the figures from the Outlook are in the collection of slides.

Chairman RYAN. Is your whole PowerPoint that you handed us up?

Jose, can you bring up Page 16 on his PowerPoint, Figure 2-3?

You have—I am very interested in your comparisons, recovery and real gross domestic product and employment, the current cycle and the average cycle since 1948, where you look at months before the trough, months after the trough.

That, yes, there. Thank you.

Give me an explanation as to why you think this is occurring? What this is showing us is our economy is not growing nearly as fast as it typically does coming out of a deep recession, and jobs are not being created anywhere close to what they are typically created coming out of a recession. If you take a look at past recessions, post-World War II, typically—and correct me if I am wrong—the deeper the recession, the bigger the bounce coming out of it. What is different this time? Why is this happening? What is your take on that?

Mr. ELMENDORF. First, a quick factual point, which is that there were revisions to employment data recently released since we completed the outlook that actually make the latest cycle look a little worse still on the employment front. We have not yet regained all of the jobs that were lost by the time——

Chairman RYAN. But this methodology is what we have always been using in the past, correct?

Mr. ELMENDORF. Oh, it is the same methodology. It is just that they have updated the data just a bit.

We think the principal reason why the employment recovery has been so weak is that the output recovery has been so weak. Output grew much more rapidly following the very severe recession in the early 1980s, for example, than it has following this recession.

This pattern, although unusual for U.S. post-war history, is unfortunately not unusual by the standards of other countries that have experienced recessions following financial crises. Those crises tend to come from an overbuilding of some aspect of the economy—in our case, particularly from housing—and have come when there have been excesses in the financial system that have been broken down in a way that takes time to rebuild. So we are watching our banks try to rebuild their capital. We are watching households and businesses try to rebuild their own balance sheets.

Those kind of recoveries tend to be slow. And we think that is the principal reason why this recovery is slow, is the severity but also the nature of the——

Chairman RYAN. Okay. So you are basically saying it is the kind of recession we had, a financial crisis driven recession, is why we have such lackluster recovery?

Mr. ELMENDORF. I think that is the principal reason, yes.

Chairman RYAN. Let me ask you this, then. Do you agree with the general conclusions of the Reinhart-Rogoff study, which more or less says financial crashes, recessions result in big debt increases and deficit increases, which gets us in a vicious cycle,

which once our debt starts hitting these troubled levels, we really start tapering off our economy? Would you generally agree with the takings of that?

Mr. ELMENDORF. Yes, I would. Carmen Reinhart is one of the members of our Panel of Economic Advisors. Of course, we read their work. And I think the point they have highlighted about how these crises lead to rapid buildups of debt is exactly what we are seeing right now in the United States.

Chairman RYAN. So their rule of thumb, 90 percent of GDP debt, do you agree with that general rule of thumb? Once you start hitting 90 percent of GDP, that is when your economy really starts slowing down; would you more or less agree with that?

Mr. ELMENDORF. I want to be careful not to suggest that we——

Chairman RYAN. I know there is not a magic——

Mr. ELMENDORF. There is a tipping point.

Their study looked, first, as you know, at gross debt; for the United States, a larger number than debt held by the public.

Chairman RYAN. We are already up at that number, then, if we are looking——

Mr. ELMENDORF. I think that is correct. We think for a variety of reasons that debt held by the public is a better measure of the government's current fiscal position.

Also, they just divided countries into buckets if you will. They picked a point of 90 percent.

But we don't in any sense doubt the conclusion that higher levels of debt lead to worse economic performance over the medium and long run.

Chairman RYAN. What is the debt held by the GDP at the end of the 10-year window in the alternative fiscal scenario?

Mr. ELMENDORF. So that particular label we applied to the long-run scenario that we did, but if you take the thing we have done in this outlook, where we have extended this particular set of policies that I mentioned, debt is pushing 100 percent of GDP by the end of the 10-year window.

Chairman RYAN. And gross debt, I guess gross debt would be——

Mr. ELMENDORF. Would be significantly larger. I don't know the number.

This is unfamiliar territory for the United States and also for other developed countries. If one looks at the set of countries in the OECD, developed countries, one does not find a lot of countries that have debt at or above 100 percent of GDP for any length of time. So we are definitely, especially if those policies are continued, moving into territory where we don't know what will happen exactly.

Chairman RYAN. I want to be judicious with my time. I think that there is a good argument to be made that interest rates are not going to be low for a long time. I think there is a good—it is worth our while to make different interest rate simulations.

You have done this for us in the past, and we have asked for this from you currently. What we have asked is, give us the blue chip average, the average of the 1990s, the average of the 1980s. If there are other worthwhile simulations run that we are not thinking of, let us know.

But also, can you carry this out in your long-run model for us as well? You can give us the 10-year numbers I know, and I know how difficult this gets, and you do your long report in the summer, but I think it would be extremely helpful to know different simulations and how it really carries out beyond the 10-year window.

The other question is—so that is just a request. Health care take-up rates in the exchanges, how many people do you project will be in the health care exchange within the 10-year window?

Mr. ELMENDORF. That is a good question. You might think I would remember the answer to that.

Chairman RYAN. I think 19 million is what I have off the top of my head. I am not sure about that.

Mr. ELMENDORF. There are some people who are in the exchanges because their employers choose to get insurance coverage for them through the exchanges. So there are some different numbers depending on exactly what concept one has in mind. But I think you are in the right ballpark.

Chairman RYAN. So other actuaries, private-sector actuaries, have made much, much different projections about the amount of which employers will drop health insurance for their employees and dump them into the exchange. I think it would be worth our while to have run some simulations on those projections as well. So how about if we shoot you projections from other actuaries who believe—I will give you one example. I have met with an employer in my district who nationwide employs 7,000 people. It is a privately-held company who has very low-margin business, who has two publicly-held traded competitors. Their competitors have basically said, we are putting our people in the exchanges as soon as we can. With a $2,000 penalty indexed to inflation per employee and they can go get health care there subsidized by the government versus $17,000 rising in health care costs, we are dumping them.

And I know you have a firewall assumption that leads to low take-up rates. But from my experience from talking to employers, I don't think that is going to happen. I don't think that firewall is going to hold. And I think tens of millions of people—this is my personal opinion, but it is informed by anecdotal conversations with employers over the State of Wisconsin and outside expert actuarial witnesses that think we are going to have tens and tens of millions of people dumped into these exchanges.

So I think it is worth our effort to run simulations to see what kind of fiscal hit we would get under this law with that.

The last question is this. And that is not a question. That is a request. The last question is, it has been argued and was argued here yesterday with the chairman, that the new health care law will create jobs and increase labor force participation. But if I recall from your analysis, it was quite the opposite. Is that not the case?

Mr. ELMENDORF. Yes.

Chairman RYAN. Okay. Thank you.

Again, I could go on and on, but I will turn it over to Mr. Van Hollen.

Mr. ELMENDORF. I am sorry. But could I use just a minute to just quickly respond to a few aspects of that, Mr. Chairman?

Chairman RYAN. Yeah. Sure.

Mr. ELMENDORF. So one thing to say is that we do show in the back of our outlook the effects of alternative economic assumptions on budget outcomes. One of the alternatives that we show is the effect of interest rates being 1 percentage point higher for the entire next decade. Under that alternative, extra interest costs for the Federal Government would be about $1.25 trillion. And if interest rates were lower by a percentage point, then they would be $1.25 trillion less in interest payments. We can certainly look at alternative——

Chairman RYAN. Yeah, your average is less than 4 percent for the decade, correct? Or what is it? Between 4 and 5?

Mr. ELMENDORF. I don't remember the average. But it is worth noting that our interest rate projection is above the financial markets' reading on interest rates. Our own model actually has somewhat higher—predicts somewhat higher interest——

Chairman RYAN. And you have just recently revised that upward, right?

Mr. ELMENDORF. We have moved between—I don't remember the revision exactly. But we put our forecast somewhere between our own modelling and what financial market participants are saying. But we can look at other scenarios, of course.

Chairman RYAN. I just think the recent movements of the yield curve and some other post-cyclical indicators warrant us looking at different simulations and seeing what the fiscal effects of that would be.

Mr. ELMENDORF. On enrollment in insurance exchanges, we project that to be 24 million by 2019, which is the last year of our original cost estimate. And we predict that only 3 million fewer people would have employer-sponsored insurance coverage.

I understand that you don't think that is right. There are many longer explanations I could give. Let me just say quickly that I know four other groups that have built sophisticated models of the health insurance system somewhat analogous to ours. Those are the Office of the Actuary at CMS; those at RAND; at the Urban Institute; and at Lew and Associates. All four of those groups show the same or less employer dropping of health insurance coverage as a result of that legislation than we show.

Now, we and they are all operating off of a very limited set of evidence, off of the effects of much smaller changes in policy than has now been enacted. And so I don't take huge comfort in their having similar answers. I think the range of true uncertainty is larger than the range of differences in our estimates. But our estimate is quite consistent——

Chairman RYAN. Sure. I understand.

Mr. ELMENDORF [continuing]. With the bulk of professional analysis of this question.

Chairman RYAN. I could go on.

Labor market participation, tightness and looseness of labor market factors into all this stuff, competing for labor based on benefits.

Mr. ELMENDORF. Yes. Exactly.

Chairman RYAN. I could go on and on and on.

Mr. Van Hollen.

Mr. HONDA. Excuse me. Would the chairman yield for a minute for a point of clarification?

Chairman RYAN. Sure.

Mr. HONDA. The term that you used, Mr. Chairman, dumping their employees into the exchange, is a definition of exchange a series of a group of insurance companies operating there or is it just one entity?

Chairman RYAN. Its employers no longer offering health insurance to their employees and sending them into the exchange.

Mr. HONDA. The definition of exchanges is——

Chairman RYAN. To an employee, they have one exchange. If I am in Wisconsin, I am going into the Wisconsin exchange.

Mr. HONDA. Right. But the exchange has many insurance companies operating within it?

Chairman RYAN. Yeah. You have gold, silver and bronze.

Mr. HONDA. Okay. So it is not that they are dumping them into something that may be less than. It could be that they give them more choices.

Chairman RYAN. Sure. But the taxpayer is on the hook for it now.

Mr. VAN HOLLEN. Thank you, Mr. Chairman.

And, Dr. Elmendorf, thank you for your testimony.

Let me just start out where I know we agree, which is the levels of debt that are projected in the CBO report in the outyears are unacceptable and unsustainable. Whether you are drawing the line at 80 percent or 90 percent or 100 percent and above, the fact remains that we cannot afford as a country to get into that kind of territory.

There is, however, I think a very important debate as you indicate in your testimony about how you get there. And I couldn't agree more with your statement that the sooner we make a decision to put in place a plan to deal with the debt in the outyears, the less painful it would be and that if you do too much in the very short term, it could be disruptive to the economy.

And, again, as I indicated in my opening statement, the bipartisan commission that was tasked with the job of identifying ways to reduce the deficit and the debt, warned that you don't want to have a negative impact on the economy and growth in the short term because we all would agree, would we not, that to the extent the economy were to slow down, that would obviously contribute in a negative way to our debt, correct?

Mr. ELMENDORF. Yes, that is right.

Mr. VAN HOLLEN. Now, it is true, isn't it, that if you were to make immediate deep cuts, that would have a—that would be a drag, at least in some measure, on the economy and the jobs in the short term; is that right?

Mr. ELMENDORF. Yes, Congressman. A year or so ago, we analyzed a set of policies being considered as ways to boost output and employment. And we looked at a variety of reductions in taxes, including the payroll tax that was enacted. We looked at some increases in government spending. Our analysis then was that under the current economic circumstances and the current posture of monetary policy, that increases in government spending would in the short run increase output in employment. And the logic works in reverse, that decreases in spending would decrease output in employment in the short run. Of course, as you understand, over

the median run and long run, the extra debt that is accumulated worsens the economic situation. But there is some tradeoff there for you and your colleagues in deciding what pace to move in putting fiscal policy on a sustainable path.

Mr. VAN HOLLEN. Right. And the President indicated in his State of the Union address that he will impose in his budget, that will arrive Monday, a 5-year freeze on non-security domestic discretionary spending, which, by his account, comes to about $400 billion in savings over a period of time.

I would just, Mr. Chairman, like to enter into the record an example of the impact of just one of the cuts that was identified by the Appropriations Committee yesterday. That is the cut to the Drinking Water State Revolving Fund of about—a cut of $1.15 billion. That is a matching fund. So States and localities have to match it. And a very respected consulting firm, RTI International out of North Carolina, has done an analysis of the impact of that cut on the economy. I mean, this is one of those kind of investments that we have talked about; this is a public investment, transportation, water infrastructure. And by their account, that cut will result in between 36,800 and 50,600 fewer engineering and construction jobs. So these decisions to withdraw investments in public infrastructure have an immediate impact on jobs in the economy.

Let me just ask you to turn quickly to the question of the different components of the challenge as we approach deficit reduction. Because one of the first actions that was taken in this House was to eliminate the PAYGO rule and replace it with a rule that was more one-sided. In other words, the rule said, well, yes, we have to take into account and pay for cuts, but not with respect to certain revenues, spending cuts. Isn't it the case that if you reduce revenues, you increase the deficit?

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

Mr. VAN HOLLEN. Well, no, but the math—I will tell you—I thank you, Dr. Elmendorf. I am not referring to the chairman here, but there have been a lot of people making statements around here suggesting that there is not a correlation there.

So as we approach this issue, it seems to me we should have rules that recognize the deficit is increased not just by actions on one side of the equation.

Let me just turn last to the health care question. And I want to ask you about the deficit impact. But before I do that, as I recall, one of the reasons you argue that—you said with respect to the labor market would have maybe some small impacts, but one of the impacts you said was that there would be some individuals who, because they can get their health care through the exchange and no longer have to get health care through their employer, would choose, would now have the freedom to choose to not get a job simply because they needed the health care; isn't that correct?

Mr. ELMENDORF. Yes, that is right. But on balance, as you mentioned, we think that the enactment of the legislation reduced by a small amount, roughly half a percent, the amount of labor that workers would supply and would be demanded and would be used in the economy over—by the end of the decade when the law was fully phased in.

Mr. VAN HOLLEN. And finally, Dr. Elmendorf, with respect to the CBO projections on the impact of the deficit going forward, as you know, one of the first actions taken by the new Congress was to repeal the health care reform law. You wrote to the Speaker of the House on January 6th of this year indicating that your assessment would be that that would add $230 billion to the deficit over the next 10 years and approximately $1.4 trillion over 20, based on your projections of GDP growth; is that correct?

Mr. ELMENDORF. So the former number is correct, and we noted carefully in the estimate that this was pending our complete evaluation using our new economic and technical assumptions. We also emphasized that that number assumed that the law would otherwise have unfolded as enacted without changes. And as we have said for a number of years now and as you have seen yourself, important changes in policy are often followed by further changes in policy. It is not clear that everything will unfold as enacted, but that is our job, is to score legislation as it was—as it is written.

The second number you did for the 20 years we did not use. We have carefully referred to longer-term budgetary effects as shares of GDP. It is not just a semantic issue. We think it appropriately signals the greater uncertainty that attends to those longer-term estimates and also appropriately adjusts for the fact that the economy is growing; there will be some inflation, that pure dollar numbers from 2025 don't mean very much to most people.

But we did estimate originally and then repeated in this letter, to which you refer, that again if the law had otherwise unfolded as enacted, that repealing it would increase deficits in the second 10 years, as well as in the first decade.

Mr. VAN HOLLEN. If I could just—one follow up. Thank you, Mr. Chairman.

But just to be clear on the second decade, as you indicated, you expressed your estimate in terms of GDP, and you did say that you believed that repealing the health care reform law would increase Federal deficits in the decade after 2019 by an amount that is in a broad range around one-half percent of GDP, correct?

Mr. ELMENDORF. Yes. That is right.

Mr. VAN HOLLEN. And CBO has done estimates of what it projects GDP to be during that period, right?

Mr. ELMENDORF. Yes.

Mr. VAN HOLLEN. And so that is how we got the figure, 1.4, was we took CBO's estimates of what GDP being would be during that year and applied the percent savings you indicated.

Thank you, Mr. Chairman.

Chairman RYAN. Something tells me this conversation is going to continue.

Mr. CAMPBELL.

Mr. CAMPBELL. Thank you, Mr. Chairman and Dr. Elmendorf.

And we will continue this conversation right now. First, on health care, before I get to broader issues, you just mentioned that you believe or that in your estimates, that the health care law would reduce the labor used in the economy by about one-half of 1 percent. Given that I believe you say there is 160 million full-time people working in 2021, that means that in your estimation,

the health care law would reduce employment by 800,000 in 2021; is that correct?

Mr. ELMENDORF. Yes. The way I would put it is that we do estimate, as you said, that the household employment will be about 160 million by the end of the decade. Half a percent of that is 800,000. That means that if the reduction in the labor used was workers working the average number of hours in the economy and earning the average wage, that there would be a reduction of 800,000 workers.

In fact, as we mentioned in our analysis last summer, the legislation also creates some incentives that might affect the number of hours people work. It might affect the propensity to work of lower- and higher-income people. We haven't tried to quantify those things, but the impact is that the 800,000 might not be exactly the number.

Mr. CAMPBELL. Sure.

Mr. ELMENDORF. The equivalent of withdrawing 800,000.

Mr. CAMPBELL. Sure. But that is your best estimate at this point.

You just pointed out that the health care law also beyond 10 years increases the deficit. And prior to 10 years, there is this whole issue about the cuts and payment rates for providers of services for Medicare programs. Can the same dollar of Medicare savings both improve the long-term solvency of the Medicare program and fund a new entitlement? Can the same dollar be used for both those functions?

Mr. ELMENDORF. So, as you understand, Congressman, the way the budget works is that if a dollar less is spent out of the Hospital Insurance Trust Fund, Part A of Medicare, that is a dollar less of overall government outlay; it improves the deficit by a dollar. It also means that the Medicare Part A trust fund, the HI Trust Fund, ends up with an extra dollar's worth of government securities that is holds.

And as we have written before, those bonds in the trust fund for Medicare and for Social Security have important legal meaning. They are real government debt, backed by the full faith and credit of the government, but they don't have much economic meaning, because as you are suggesting, if one saves a dollar by not spending it in someplace and one then spends the dollar in some other place, one has not improved the ability of the government to ultimately meet future Medicare or Social Security obligations. And thus the total increment to the HI Trust Fund from the health legislation enacted last year was much larger than the increment that we estimate to government saving. And that excess is real bonds for the trust fund but does not reflect an improvement in the government's ability to meet those later Medicare objections.

Mr. CAMPBELL. And if you don't double count this, it does change the numbers or the computations for the first 10 years, does it not?

Mr. ELMENDORF. I want to be careful. We do not double count. We kept track of every piece of legislation and its effect on the budget once and only once. But our estimates refer, as all of our estimates do, to the effects on the unified—the overall government budget. So there is no double counting that we have done. I think the issue you are raising is whether—is how many benefits of the

legislation one can claim credit for at the same time. But that is not my end of the business.

Mr. CAMPBELL. Okay, well, unfortunately, I now have just slightly over a minute to get to what I wanted to get to.

But, other than this, but suffice it to say on the health care plan, you think it is going to reduce employment over 10 years. It certainly increases the deficit after 10 years. And there clearly is debate about what it does within 10 years. So how that is good for what we are talking about here in the Budget Committee, I don't know.

But in my remaining minute, I just wanted to mention real quick, first of all, I share the chairman's accolades as far as CBO and yourself and what you all do and that you have a very difficult job. You have to predict not only the vicissitudes of interest rates and the marketplace and GDP, but the vicissitudes of Congress as well and what we are going to do and what we are not going to do.

And when I look at the baseline projection versus your alternative, when the baseline includes tax increases, which nobody currently is advocating, including the President, including Democrats in Congress, including Republicans in Congress—what it includes, cuts to Medicare—or to the so-called doc-fix providers that none of us have as of yet have been willing to do and so forth. I look at the alternative scenario as a much more likely scenario based on what is going on. And I can go through other things. I mean, your interest rate projections, even though you moved them up, still you have the 10-year Treasury bond below anything it was at during all the 1980s and the 1990s and through much of the 1970s, I believe if I have your figure, 2.7, right. So anyway—now my time is up. But the whole point is that this 100 percent of GDP debt in 2021 is a realistic possibility and not some pie in the sky number?

Mr. ELMENDORF. So, Congressman, we are not trying to predict what you and your colleagues will do. We are trying to illustrate the effects of alternative policy paths. It is up to you all to judge what you think is likely. But we do say in the report that with more and more large pieces of policy being set on a explicitly temporary basis, with many Members talking about their interest in extending those, we think that the current law baseline is—has become less useful in showing the thrust of current policies and that is why we are trying to illustrate some alternatives for you.

Mr. CAMPBELL. Thank you.

Chairman RYAN. Ms. Schwartz.

Ms. SCHWARTZ. Thanks. Ms. Schwartz is hard to say. I recognize that.

I will not ask you to repeat it because you have been absolutely very clear in the answers to the previous questions that the health law that is law of the land now reduces deficits over 10 years and over 20 years? And you have not double counted anything?

Mr. ELMENDORF. That is correct, Congresswoman.

Ms. SCHWARTZ. Thank you.

I am sure we will be saying that over and over again. But you keep saying it. Everybody else says it. It is—and we keep hearing that it is not understood by the other side.

What I want to do is try and just focus on a couple of statements you have made, but I wanted to just reiterate some of them and be clear about where we are on the budget deficit and where we are going.

We all agree that the deficit is a problem and the national debt is a problem and that we want to reduce the deficit. Lots of ideas out there about how to do it.

But in the short term, the Republican majority has made—I will try to ask the questions in a short way and ask you to answer them in a short way. They have changed the rules of the way we count spending and what adds to the deficit in this new Congress. We went from PAYGO rules to CUTGO.

Mr. ELMENDORF. The House Rules have changed. We count the deficit the same way. We add up all the——

Ms. SCHWARTZ. That is what I want to make sure about. That is what I wanted you to answer about. The new rules actually say that they have to find a way to—if they are going to do spending cuts—no, that is going to—they have to offset any spending changes, but they don't have to offset or really count in their rules—you will have to do it generally—count any changes in tax policy, tax cuts in particular.

So just to relate this to a family budget, it is like saying, all right, if things are tight, we are going to cut back on going out to dinner or going to the movies or entertainment for our kids. We just can't afford to do it. But in fact, if you get laid off from work and you have no more salary, we are not counting that and maybe our checking account won't notice. Isn't that kind of what they are doing? You can't do it, but that is what they are saying they are going to do? We are not going to notice there is less money coming in?

Mr. ELMENDORF. Well, Congresswoman, we keep track of all the changes in spending and revenues. And reductions in revenues increase the deficit, just as increases in spending increase the deficit.

Ms. SCHWARTZ. So you will help us keep on track? We can go to CBO; you will actually be able to tell us that this could and will add to the deficit if, in fact, there are tax cuts, for example, that they don't want to pay for.

Mr. ELMENDORF. The structure of our cost estimates is not altered by this change in the House Rules.

Ms. SCHWARTZ. We are going to look towards you to actually help us with that and help the public understand that that is adding to the deficit, not helping us fix the deficit.

Second, they also are looking at the budget as only cutting—they only want to cut spending in one piece of the budget. They are only looking at cutting proposals for spending in nondefense discretionary. Now the average American, what does that mean? So I am going to ask you, what percentage of the budget is that? They are looking for all the spending cuts, particularly the early ones, to come out of one part of the budget. Is that the biggest part of the budget? What part of the budget is it?

Mr. ELMENDORF. No, it is not. So, as you know, the government spends much more on the mandatory programs, entitlement programs, than it does in discretionary spending.

Ms. SCHWARTZ. And defense? What about defense?

Mr. ELMENDORF. So I have in hand in front of me the numbers for 2021, if one looks at the end of the decade, at which Social Security would be 21 percent of government spending; the major health programs would be 27 percent; defense would be 15 percent; net interest payments, 17 percent; and other—all other spending 20 percent, one-fifth. That is under the assumption that certain policies are extended.

Ms. SCHWARTZ. Can we get to deficit reduction if the only—at least for the short term, the only issue on the table is 18 to 20 percent of our budget, and they are going to take all of these cuts, pretty dramatic ones in some cases, from one part of that budget? Most economists, most advisors have said you have got to look at everything. Everything has got to be on the table, both tax revenue, tax policy, spending in all categories, in order to actually get to serious deficit reduction. So that between the rules of the way they are going to do any of the work they are going to do going forward, ignore the big piece that is tax cuts, and they are also now looking for all of the spending cuts to come out of really just one piece of the pie, under 20 percent.

Mr. ELMENDORF. So, Congresswoman, the policy choices are yours and your colleagues. It is certainly true that the piece of the pie represented by nondefense discretionary spending is not a very large piece of the government's total spending. Trying to—one can reduce the deficit with any given piece. But if one wants to achieve a goal of stabilizing the debt-to-GDP ratio or a more ambitious goal of balancing the budget, then just as a matter of arithmetic, that is very hard to do focusing on just one-fifth of the budget.

Ms. SCHWARTZ. Thank you.

Chairman RYAN. Thank you. I would just simply say we are here in a CR because the majority last year didn't pass a budget at all, nothing. They passed a CR that goes until March 4. So here is where we are. Discretionary spending is what is on the table right now because the last majority didn't pass a budget. I just want to ask you one quick question. Can you count class-act revenues both to go to the CLASS act and to pay for a new entitlement?

Mr. ELMENDORF. If revenues are collected——

Chairman RYAN. Can you use class-act revenues to go to CLASS act and a new entitlement? Can you use Social Security revenues to go to Social Security and a new entitlement? Can you use Medicare cuts to go to Medicare solvency and pay for a new entitlement? Can you use both those dollars for both purposes?

Mr. ELMENDORF. One can't use a single dollar to pay a dollar of benefits here and a dollar of benefits some other place.

Chairman RYAN. Thank you.

Mr. VAN HOLLEN. Mr. Chairman, if I could just briefly on that.

Chairman RYAN. I indulged, so I will let you indulge.

Mr. VAN HOLLEN. Let me just say with respect to the point on the budget resolution.

Number one, we did pass the budget enforcement resolution, which applied for one year, one year, this current fiscal year 2011, I would point out that that budget enforcement resolution was less than the budget numbers submitted by the President. We then enacted a continuing resolution.

Chairman RYAN. So March 4.

Mr. VAN HOLLEN. Till March 4th, which, of course, was even below the budget resolution act that we have had. And now we are talking about reducing that further. So the reality is that we did have a 1-year budget resolution for this fiscal year.

Chairman RYAN. Well, we can go back and forth, but I am trying to challenge the presumption that we are suggesting we can balance the entire budget on this narrow slice of the budget. No, we are not making that assumption. We are in discretionary because a CR is expiring March 4. With that, I will go to Mr. Calvert.

Mr. CALVERT. Thank you, Mr. Chairman.

Doctor, in your testimony, you say to prevent the debt from becoming unsupportable, policymakers must cut spending, raise taxes or adopt some combination of these. But your own report states that raising taxes have consequences as well. In part, on page 25, it states that if growing interest costs were financed by raising taxes, quote, those rates could discourage work and savings and further reduce output. Could you describe further how raising taxes negatively affects work and saving?

Mr. ELMENDORF. So the reward that people get from working and saving is the amount that they take home from their job or the amount that they can take out of their bank account for investments later, and that depends both on what the employer is paying or the investment is yielding and also on the tax payments they need to make on that to the government. Increases in marginal tax rates, which are the rates you pay on the additional dollar of income, will tend to discourage work and saving.

Mr. CALVERT. It sounds like the old Laffer curve.

Mr. ELMENDORF. Well, the Laffer curve is a particular extreme version of that. I was going to say, there is a lot of debate, a lot of research and a lot of debate among economists about how sensitive work and saving are to those tax rates. The Laffer curve, which as Professor Laffer noted this morning in an article newspaper, is a concept that predates him by probably centuries, says that there is a point at which making tax rates even higher tends to reduce revenue, that you lose more than you gain.

Mr. CALVERT. I think it would be an accurate statement that if you tax someone 100 percent of their revenue, there is no inducement to work.

Mr. ELMENDORF. That is right. I think a very wide spectrum of economists think that most tax rates in the United States today are not at or beyond that peak of the Laffer curve. But as I said, there is disagreement about just where that peak is and how large the disincentive effects are.

Mr. CALVERT. As customary, your baseline revenue estimates are based on current law. As such, the figures for 2013 and beyond assume increases in marginal tax rates, expansion of alternative minimum tax; various other tax hikes are scheduled to occur under current law, as you know. Based on the table of selective policy alternatives, the scheduled tax law would amount to a total tax increase of about $3.8 trillion through 2021, and revenue would rise to about 20 percent of GDP. Even with that significant tax boost—if, in fact, that was accurate—would revenues ever even come close to catching up with spending with what is going on today?

Mr. ELMENDORF. Well, revenues get closer, but that is not sufficient. As you say, our baseline projections include the expiration of those provisions in the tax law, and we show deficits continuing——

Mr. CALVERT. And even looking beyond the 10-year window, isn't it fair to say that spending under the current policy would continue to outpace revenue even if the tax revenues were built into the baseline projection?

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

Mr. CALVERT. Thank you, Mr. Chairman.

Chairman RYAN. Mr. Doggett.

Mr. DOGGETT. Thank you very much, Mr. Chairman.

I want to agree with the expression of concern that Chairman Ryan has made concerning the growth of our debt and as well to agree with the need for us to ferret out every inefficiency in spending we can find and indeed to make some cuts in spending even of programs that are performing well because of the size of that debt.

The concern that I have—and I am not asking you to take sides with reference to that concern—is the overly narrow focus of the chairman's approach to our debt problem. And let me ask you if it is not true that unpaid-for direct expenditures and unpaid-for tax expenditures have the very same effect on the size of our national debt.

Mr. ELMENDORF. Certainly, Congressman, the dollar of extra spending and a dollar——

Mr. DOGGETT. A dollar of lost revenue?

Mr. ELMENDORF. Just as a dollar of lost revenue widens the deficit by a dollar.

Mr. DOGGETT. And indeed, in terms of the size of what has been left off the table by the chairman, the size of total tax expenditures each year most observers have estimated rival the total amount of direct discretionary expenditures; isn't that correct?

Mr. ELMENDORF. I think that is right. Estimating the total effect of tax expenditures is difficult because of interactions among other things.

Mr. DOGGETT. Exactly. But both are big.

Mr. ELMENDORF. I have seen it suggested that it is a very large number, yes.

Mr. DOGGETT. So, really, when we make decisions about how we are going to deal with this debt, one of the things we can do is to cut direct spending. We can say families are just going to have to fend for themselves; we are going to cut the budget of law enforcement with regard to the Wall Street banks, with regard to the Wall Street security companies, with regard to the health insurance monopolies. We would like to do something about that, a little bit, but we just can't afford to do it any more. And we can't afford clean air and clean water. We don't want as much environmental law enforcement as we have had. Let's cut that by $4 billion a year, and that might be one way to address the deficit, but can't we achieve the very same thing if we conclude that a provision in our tax laws that allows Wall Street financial enterprises to enjoy preferential treatment on some of their financing operations abroad and takes

$4 billion a year by closing that tax loophole, wouldn't it have the same effect on the deficit?

Mr. ELMENDORF. Dollar per dollar——

Mr. DOGGETT. Dollar per dollar. And the same thing with reference to cancer research, with reference to scientific research that might spur additional job growth. If we cut that by $500 million a year, that will help us solve the deficit but perhaps with some very negative effects.

Or we could eliminate the $500 million a year in what is called the look-through rule that advantages some multinationals in their interest, rents and royalties that they earn abroad, and it will have the same effect on the deficit. It is a choice that we need to make.

Would we rather continue to advantage these foreign operations, some of which may actually encourage the export of American jobs overseas, or do we think it is better to cut cancer research and cut scientific research? That is really the choice the committee has to make rather than you, right?

Mr. ELMENDORF. Yes, Congressman.

Mr. DOGGETT. And that is the problem with the narrow focus that the chairman and the Republican majority have brought to this hearing today.

They only want to look at half the problem. And I believe we need to look at all of the expenditures and especially the many tax advantages, tax preferences, exemptions that powerful lobbyists with their string of limousines up here have been able to get into our Tax Code.

And that is not being done by this hyper narrow focus that the majority has in this budget process.

Now, let me ask you about another aspect, and that is your estimates on job creation. You analyzed last year what would be the most effective ways to encourage job growth in our policies. And isn't it correct that one of the least efficient ways to encourage job growth is to extend permanently the Bush-Cheney tax breaks for the wealthiest people in our society?

Mr. ELMENDORF. Congressman, we did estimate that extending the across-the-board extension of the 2001/2003 tax cuts would have a low bang for the buck, affecting the economy per dollar with wider deficits.

Mr. DOGGETT. Right. Your conclusions were the same as almost every expert who has ever come before this committee, Republican or Democrat, that those tax cuts won't pay for themselves, that they will add significantly to the deficit, that they are an inefficient way to create job growth. If the objective is to encourage more job growth than what you have predicted, extending the Bush tax cuts permanently for the wealthiest in our society is the wrong way to go.

Thank you.

Mr. MCCLINTOCK [presiding]. The chair recognizes me.

Dr. Elmendorf, thank you for coming. My first question is spending. Under George Bush, would you say that spending grew faster or slower than it did under Bill Clinton?

Mr. ELMENDORF. Total Federal spending?

Mr. MCCLINTOCK. As a percentage of GDP.

Mr. ELMENDORF. I am sorry, I don't know the answer to that question. So total Federal outlays in fiscal year 2008 were about 2.5 percentage points of GDP above where they were in 2000. And in 2000, they were about 4 percentage points of GDP below where they were in 1992.

Mr. MCCLINTOCK. So spending grew much faster under George Bush than it did under Bill Clinton?

Mr. ELMENDORF. Relative to the growth of the economy, yes, Congressman.

Mr. MCCLINTOCK. How about deficits under George Bush, would you say they were bigger or smaller than they were under Bill Clinton?

Mr. ELMENDORF. They were a good deal bigger, Congressman.

Mr. MCCLINTOCK. Tell us, didn't we have a big stimulus program in February 2008 under George Bush where we all got $600 checks to stimulate the economy?

Mr. ELMENDORF. There was, yes. I don't remember the total size of that legislation, but yes, those checks were issued.

Mr. MCCLINTOCK. Well, if higher and higher spending and bigger and bigger deficits and massive government stimulus spending was the root to prosperity, I would have thought that the George Bush administration would have ended with a new golden era for the American economy. I wonder how that happened. I guess that is a rhetorical question. I will move on.

Mr. Van Hollen warned us earlier today that the deep cuts would be a drag on the economy. I was wondering if you could tell us about the great depression of 1946.

Mr. ELMENDORF. Congressman, as you know, there was not a great depression of 1946.

Mr. MCCLINTOCK. There wasn't a great depression in 1946? Well, how could that possibly be? In 1945, Harry Truman abolished the excess profits tax. He slashed Federal income tax rates. In 1946, Harry Truman cut Federal spending from $85 billion down to $30 billion in a single year. He fired 10 million Federal employees. It was called war demobilization. How would you characterize the post-war economy under Harry Truman?

Mr. ELMENDORF. The economy performed well in the wake of the Second World War. It actually was a surprise to macro-economic forecasters at the time. It is an interesting episode in the period of economic thought.

Mr. MCCLINTOCK. Yes. The Keynesians at the time, as I recall, were predicting a 25 percent unemployment rate, a second great depression. And instead, we had the post-war economic boom. That is very interesting. Maybe we stumbled upon something here.

Mr. ELMENDORF. In fact, economists changed their models ever since that point to reflect some of the things that they learned during that episode.

Mr. MCCLINTOCK. Apparently they haven't changed those models enough in the current administration.

Mr. ELMENDORF. I am not sure what you are suggesting. I think that the models that CBO uses for this and other sorts of analysis are at the cutting edge of the models that economists in universities and the private sector use for the questions that we analyze.

Mr. McCLINTOCK. I am glad to hear that. Are there any other periods in our Nation's history when our debt to GDP was comparable to what it is now?

Mr. ELMENDORF. Well, during World War II, as you know, the debt ran up to a point above 100 percent of GDP and then fell from that point during the 1950s, 1960s, and 1970s relative to GDP.

Mr. McCLINTOCK. Right. And any other times?

Mr. ELMENDORF. I wrote a paper once, but I forget, Congressman, the nature of debt in the——

Mr. McCLINTOCK. The Revolutionary War debt, I believe, brought us to about that same height, as I recall.

How were those debts discharged?

Mr. ELMENDORF. Well, so in the wake of the Second World War, what happened was the government's budget ran small deficits mostly, but was close to being in balance, so there was a nominal amount of government debt. It didn't change very much, and the economy grew. So, as a burden on the economy, debt fell relatively.

Mr. McCLINTOCK. So Harry Truman slashed taxes, slashed spending, slashed Federal employees, and the economy grew out of a debt comparable to the one we have now?

Mr. ELMENDORF. That is right, Congressman.

As you understand, of course, the path of the budget and the debt depends not just on the policies that you and your colleagues enact, but also on the economic circumstances. And your policies have some effect on those, but also there are many other influences and economic circumstances.

One of the things that we take seriously in our——

Mr. McCLINTOCK. If I could, my time is fleeting, so if I can move on to a final question here.

Mr. Van Hollen earlier today said that we must not jeopardize the full faith and credit of the United States Government, and we all agree with that.

Tell me, would the full faith and credit of the United States Government be strengthened by requiring first call on revenues to go for debt service as most other States already require?

Mr. ELMENDORF. To be honest, Congressman, I think that is unclear. The government has a range of obligations. It might be the case that protecting certain obligations and not others would then strengthen confidence in the government's commitment to paying those obligations.

On the other hand, it might be the case that the government not honoring all of its obligations would then cast doubt on its commitment to honoring any of those obligations.

I think most analysts with whom I have talked, and I have talked with a fair number, think that were the government to default on any of its obligations, those to debt holders and also to those people with regular contracts with the government and so on, that would represent a rolling of the dice about investors' perception of the safety of U.S. securities. I don't know any analysts who think that the government should roll those dice and see what happens.

Mr. McCLINTOCK. Funny, other States do it all the time.

Ms. McCollum is next.

Mr. ELMENDORF. Other States pay higher interest rates than the U.S. Treasury does, Congressman.

Mr. MCCLINTOCK. Ms. McCollum.

Ms. MCCOLLUM. Thank you, Mr. Chairman.

I would like to start my comments with a reflection on a misstatement made during the hearing yesterday. After I left yesterday's hearing, the gentleman from Missouri, Mr. Akin, referenced my statement, twisted my words into something I neither said nor implied, and I am sorry he is not here. He was here earlier.

I hope the gentleman's misrepresentation of my comments does not reflect the manner in which this committee will conduct itself in the future.

As Mr. Akin is from the Show Me State, I brought the transcript of yesterday's hearing with me, and I would like to enter that in the record, but right now I would like to read from the transcript.

"Mr. Akin. The comment was made earlier I thought which was an amazing quotation from Ms. McCollum that the budget deficit is not a spending problem. I found that amazing because it seems to me that it sure is a big spending problem. So we must be on different planets, I suppose."

Mr. Chairman, I don't know what planet Mr. Akin lives on, but in the real world, I pride myself in conducting myself with respect and civility with my colleagues.

For the record, I wanted to restate my comments from the hearing transcript.

"Ms. McCollum. I am going to paraphrase a popular Tea Party slogan that goes something like this, quote, the Federal Government doesn't have a revenue problem, it had as a spending problem."

I went on to say, "Chairman Bernanke, it seems clear to me that the deficit is not just a spending problem."

Nowhere in my statement did I say the budget deficit is not a spending problem.

For new Tea Party members here on the committee, this is a good moment for a little bit of history. Mr. Akin and I both entered Congress in 2001.

Mr. Elmendorf, am I correct remembering back in 2001, there was a projected 10-year budget surplus of $5.6 trillion?

Mr. ELMENDORF. It was a large positive number, Congresswoman. I am sorry, I don't remember the exact figure.

Ms. MCCOLLUM. At the time, Mr. Akin's party, the Republican Party, before the addition of the Tea Party, controlled the House here and the White House. The surplus that President Clinton left the American people quickly vanished after President Bush and Mr. Akin entered Congress, as was pointed out by the gentleman in the chair right now.

Mr. Elmendorf, am I correct, or correct me if I am wrong, that in 2001 and 2003, the Bush tax cuts, which I voted against and Mr. Akin voted for and favored, contributed to the growth of the deficit by trillions of dollars?

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

Ms. McCOLLUM. Again, Mr. Elmendorf, correct me if I am wrong, but the war in Iraq, which I opposed and Mr. Akin voted in favor for, added to the Federal deficit by nearly a trillion dollars?

Mr. ELMENDORF. Yes, Congresswoman. It may be over a trillion dollars; I am not exactly sure. It is a big number, though, as well.

Ms. McCOLLUM. Mr. Elmendorf, I also believe it is correct to say that the December vote to extend the Bush tax cuts added $858 billion to the Federal budget deficit; is that not correct?

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

Ms. McCOLLUM. I raise this because this is another example of where Mr. Akin and I disagree. He voted to add $858 billion to the deficit by voting for tax cuts. Included in that were NASCAR's racetrack owners, tax breaks for Caribbean rum manufacturers, along with extra tax cuts for millionaires and billionaires. And I voted against the deficit-busting bill.

So Mr. Akin is very concerned about spending. His record to me would indicate that he has voted to add trillions of dollars to the national debt.

Now, Mr. Elmendorf, what would be the effect on future deficits if Congress were allowed to let the Bush tax cuts expire in 2012? And did not the economic growth we saw under President Clinton include a tough vote, in which no Republican helped Democrats' vote, that included a tax increase?

Mr. ELMENDORF. So, Congresswoman, as you know, our baseline projections, which follow current law, assume that the tax cuts now scheduled to expire, expire. As we show one of the policy alternatives in the report, if one instead, if you and your colleagues instead voted to extend those expiring tax provisions, that would add trillions of dollars to the deficit over the next decade and thus to the accumulated level of debt by the end of the decade.

You are also right, Congresswoman, of course, that in the 1990s, a number of votes were taken to change policies in ways that reduced the deficit, and those actions, together with the strong economy, led to budget surpluses at the end of the 1990s.

Ms. McCOLLUM. Just to clarify, because the clarification was that tax cuts were part of that decision under the Clinton administration, to remove the tax——

Mr. ELMENDORF. A change in tax policy is part of what happened, yes.

[The information follows:]

FEBRUARY 9, 2011, BUDGET COMMITTEE HEARING TRANSCRIPT EXCERPTS SUBMITTED BY MS. McCOLLUM

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[REMARKS BY REP. MCCOLLUM]

Ms. McCOLLUM. Thank you, Mr. Chairman. Chairman Bernanke, thank you for being here. I believe that we have a lot of work ahead of us, and I want to thank you for the work that you did in stabilizing our economy in the past, and I look forward to hearing some of your advice, suggestions, and ideas on how we move forward with getting out of the Great Recession. And I want to be part of the solution, and we hear a lot of talk here in Congress about spending, but I'm also concerned about a lot of the tax perks that lobbyists have been very successful in getting for special interests in our tax code, and I think that we need to put everything on the table.

But having said that, today, we've focused on spending quite a bit, as some of the questions have come through. And in fact, I'm going to paraphrase a popular Tea Party slogan; it goes something like, quote, "The federal government doesn't have a revenue problem, it has a spending problem."

Now last week, Chairman Ryan put forward his best effort to reduce the deficit with spending target cuts, that is $41 billion from the fiscal year 2011 budget. The Republican target reduces the fiscal year 2011 projected deficit by about 2.5 percent. That leaves 97.5 percent of the deficit intact.

Now, in an extreme scenario, if all 176 Republican Study Committee members were able to have their way and take control, they would be allowed to cut four times what Chairman Ryan's best effort is. But that would only then still only represent 10 percent of the federal budget deficit for fiscal year 2011, still leaving more than 1.3 trillion.

Chairman Bernanke, it seems clear to me that the deficit is not just a spending problem. Is it possible to reduce the federal deficit to responsible levels without capping or cutting defense spending and without looking at the tax perks that many corporations and lobbyists have been successful in getting?

And my second question is: With the type of cuts that are being discussed, do you think that we need to be insightful when making these spending decisions on what to cut, on the impact of jobs as well as U.S. competitiveness, and the global economy? I think we need to be careful of gutting domestic investments in education, infrastructure, and R&D in the next decade, because we might see reverses that would put us at a competitive disadvantage.

Mr. BERNANKE. Well, on your second question, I'm hoping to, obviously, it is very important that the deficits be brought under control, but it is not just a matter of total spending and total revenues, it is also how smart is the spending and how are we using it? And the tax code, are we doing it in a way that is constructive for growth and for competitiveness?

So, I would urge the Congress not only to talk about total budget numbers, but also to think hard about the various programs and tax provisions to make sure that they are growth friendly, and that is a very important part of your job.

In particular, you mentioned perks, et cetera. I think one direction that at least should be considered would be, in the corporate tax code, for example, to reduce a lot of loopholes, to broaden the base, and therefore be able to lower the tax rate, which is now soon going to be the highest in the industrial world so that the decisions made by corporations are based, you know, not on tax distortions, but rather on the economics of where, for example, they should locate their plants, and so on.

So, I do think that growth friendliness is a very important part of this and that lower rates and broader base is something that most economists would agree is a good direction to go in the tax code.

On short-run versus long-run, I, again, I understand there's a lot of focus on this year's budget. Without commenting directly on that, I do think that in order to be credible, given that the budgetary problems get worse over time, that is as the baby boomers retire, as health care costs rise, and so on, given that the prospective deficits are rising over a long period of time, I would hope that a good bit of your discussion will be about the long-term over the 10, 15, 20 year horizon and to the extent that you can change programs that will have long-term effects on spending and revenues. That will be a more effective and credible program than one that focuses only on the current fiscal year.

Ms. MCCOLLUM. Thank you, Mr. Chairman. As you know, we are setting the budget. We're setting the spending and Ways and Means does its issues with the tax code and addressing what I hope will be any tax perks. But I can't make a decision in isolation, so I look to all of us to put everything on the table so that we make a well-rounded decision as we move forward with the budget. So, Mr. Chairman, I'll be looking to see what your comment is.

Chairman RYAN. Thank you, Ms. McCollum, and I can only say what we are doing right now is our best; it is our first effort at getting fiscal control under this place. Mr. Ribble.

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[REMARKS BY REP. AKIN]

Mr. AKIN. Thank you, Mr. Chairman. It seems like when we talk about dealing with the budget deficit, it reminds me a little bit about these all kinds of imaginative weight-loss programs, you know? It seems like when you get down to the bottom line, you can either eat less or you can exercise more. You're only given two alternatives. It seems like we are in the same way, we can try and sugar-coat it,

but the problem is that either we are spending too much or we've got to tax a whole lot more. The comment was made earlier, which I thought was an amazing quotation from Ms. McCollum, "The budget deficit is not a spending problem." I found that amazing, because it seemed like to me it sure is a big spending problems. We're just on different planets, I suppose, but let's just assume, instead of you are going to cut spending, that you are going to try to increase taxes.

Now, my understanding is, I take a look at historic data, our tax revenues run somewhere in that 18 percent range. My understanding is if we were to double the tax rate on everything across the board, we couldn't assume that we are going to get double in revenue, federal revenue.

In fact, we may well do what you are saying, crash the economy and get even less. I do recall, we did dividends, capital gains, and death text in May 2003, and the Congressional Budget Office said, "Well, now you are going to have less revenue," but in fact, there was more revenue because the economy kind of got going.

So, my question is, when I take a look at this overall problem that we are, you know, too heavy, in terms of like a weight loss thing, it is pretty spooky to me because you add all of the entitlements, the main ones, Medicare, Medicaid, Social Security, and then the other kinds of entitlements, and add debt service to that, and it seems, when I looked at the numbers, it was looking like about 2.3, roughly, trillion. And our revenue is about the same thing. So that says you get zero defense, zero discretionary non-defense, and you are right now just a parody. So, I don't understand. I guess my question to you is, first of all, don't we have to, essentially, deal with the entitlements, just by definition, or can you actually make it up by just doubling taxes and hope there's going to be a ton more revenue?

Mr. BERNANKE. Well, I think that, as you point out, I mean, that in the long run, the way we are going, entitlements plus interest would basically be the entire government budget, and so, unless you raise taxes considerably. Now it is up to Congress to find the right balance between taxes, and cuts, and so on, of course. But I think you need to look seriously, particularly at the health care costs, which is of course, part of what has been going on the last couple of years here in Congress, but I think a focus on the cost side is important.

And, it would be difficult, I think. I'm very loath to prescribe exactly how to address these issues; I do think that it would be very difficult to leave health care programs untouched and still achieve budgetary balance in the next 15 years.

Mr. AKIN. Thank you. I think what I heard you saying is, is you really got a deal with that rate of spending, and particularly, in the entitlement, the health care piece is such a big part of that, that has to be dealt with. And that raising taxes, just to finish the question.

Mr. MCCLINTOCK. I am sorry, we are out of time.

Mr. AKIN. Thank you.

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Mr. MCCLINTOCK. Mr. Stutzman.

Mr. STUTZMAN. Thank you, Mr. Chairman.

Thank you, Doctor, for being here today.

I want to go back to what Mr. Calvert was talking about a little earlier with the tax rates and where we are at with our current tax rates and specifically the corporate tax rate.

The President in his State of the Union Address: closing loopholes and lowering the corporate tax rate. My question is, would you agree with that, and how might that be accomplished? We have seen that other countries around the world are starting to adjust. Is the corporate tax rate maybe over the crest of a good Laffer curve, and are we starting to see job loss because of higher taxes and, obviously, I would say, more regulation?

Mr. ELMENDORF. So we have not done analysis to identify the peak of the corporate Laffer—tax Laffer curve. But I think there is widespread agreement among analysts that lower tax rates applied to broader bases are a much more efficient way to raise any given amount of revenue that the Congress wants to raise.

And we have some work underway that we hope to release soon that looks at our treatment of international aspects of the corporate

business and how that is taxed and compared with the way other countries address those issues, and we hope that will be helpful to you and your colleagues in thinking about this question.

Mr. STUTZMAN. So you will be taking a look at other countries around the world that have adjusted their corporate tax rates?

Mr. ELMENDORF. It is a comparison. The study looks at how adopting different sorts of systems or the sorts of that exist in some other countries might affect incentives for U.S. companies to engage in various kinds of behavior.

Mr. STUTZMAN. Okay. We all talk about simplicity and simplifying the Tax Code, and would you agree that we have a very complex Tax Code and that it and should be simplified?

Mr. ELMENDORF. No doubt. Again, I think it is a very widespread view that a simpler Tax Code would be more efficient in terms of people and companies spending less time filling out forms and would also be perceived probably as being fairer than the complicated tax system that we have now.

Mr. STUTZMAN. I think that the American people obviously want both sides to fix the problems in Washington. And you know, we can sit here and point fingers at each other all day long, but that is not going to fix the problems. I think they want simplicity. I think they want fairness and equitable taxation. The proposal has been thrown out with a flat tax or the fair tax. Could you comment on one of those? I mean, is that part of a solution?

Mr. ELMENDORF. So we haven't studied those proposals specifically. You know, in order to reduce the deficit, one has to either spend less or raise more revenue. It is, again, I think a widespread view among analysts that if one wants to raise more revenue than some benchmark, that it is more efficient to do so if one has a better tax system in the sense of having a broader base and lower tax rates.

The discouraging effect on work and savings, as I discussed earlier with one of your colleagues, come really from the level of tax rates. One can, as we did as a country in 1986, restructure the tax system in a way that can bring down tax rates while broadening the base. But again, if one wants to reduce the deficit through this action, one has to ultimately raise more revenue than under some alternative.

Mr. STUTZMAN. But raising more revenue is obviously through growing the economy, not just raising taxes?

Mr. ELMENDORF. That is right. But as Chairman Bernanke said yesterday, and as many people have said, the size of the current imbalance between spending and revenue in the United States is not something that can be closed through any conceivable feasible growth rate.

Mr. STUTZMAN. Do you have any idea, how do we compare, as far as our regulatory measures in this country, compared to around the world? We know some countries are already adjusting corporate tax rates. Are they also adjusting and correcting their regulatory systems as well?

Mr. ELMENDORF. So there are certainly changes going on in lots of places. In a lot of other developed countries, in Europe, where they are feeling fiscal stress, there are changes, important changes

in policy, that are meant to help those economies grow faster, as you said, and to make other changes in budget.

We need to remember, of course, that most other developed countries are starting from levels of revenue relative to GDP that are a good deal higher than the levels in the United States. So if they bring those down, they are bringing them towards us, for the most part, not beyond where we are.

And, of course, a number of countries are raising tax rates. The government in Britain, for example, is raising taxes as well as cutting spending. They are working on both sides of the ledger in an effort to reduce very large budget deficits.

So different countries are doing different things, hopefully an appropriate response in their situations, but that is not always clear.

Mr. MCCLINTOCK. Mr. Honda.

Mr. HONDA. Thank you, Mr. Chairman.

Good morning, Dr. Elmendorf.

We all agree that the trajectories of our national deficit and debt are unsustainable and that they place our Nation's future in great peril, and that it is this committee's responsibility to make this right for the American people.

Relative to Afghanistan and other things, the only way we can make it right is if we are honest about what has placed us in this predicament. Republicans have placed the blame entirely on Social Security, Medicare, discretionary spending, which provides for our working families and our parents in their old age. They want us to ignore that two policies of the Republican Party, the Bush tax cuts and the wars in Iraq and Afghanistan, accounted for over $500 billion of the 2009 deficit and, including interest, will account for almost $7 trillion over the next decade.

So my question to you is this, would the savings that resulted from ending combat operations in Iraq and Afghanistan and allowing the Bush tax cuts for the wealthy to expire reduce projected deficits?

Mr. ELMENDORF. Yes, Congressman. Relative to the alternatives, yes.

But I want to emphasize that our baseline projections include the expiration of the Bush tax cuts. So the baseline projection of deficits of $7 trillion include that expiration. They do not include a more rapid drawdown of troops overseas. We offer an alternative in our outlook that picks a particular scenario in which that reduction would reduce deficits by an additional $1.25 trillion. It still leaves deficits in excess of $5 trillion over the coming decade.

Mr. HONDA. And the technique that we use with a war on terror or Afghanistan and Iraq, if you will, the supplemental, is that something that is directly attributable to the deficits that we are experiencing and a growing national debt, in the way it is being done now?

Mr. ELMENDORF. Any form of spending, additional spending, or tax reduction, will widen the deficit. So whether you enact that spending through a regular appropriation or supplemental——

Mr. HONDA. Is that a "yes" to that question?

Mr. ELMENDORF. Well, I am not sure that I understand you. It doesn't matter for the ultimate effect on the deficit whether you enact something in a supplemental appropriation or a regular ap-

propriation. It is just a matter of your authorizing the government to spend money.

Mr. HONDA. And obligate.

Mr. ELMENDORF. Yes.

Mr. HONDA. And create a deficit that is not balancing the budget that would be financed from somebody that would be added to our national debt.

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

Mr. HONDA. Thank you.

The other one is investing in education and infrastructure. In your testimony, you highlighted the jobs crisis that continues to confront working and middle-class families. You cited two culprits, the anemic growth rate and structural changes in the labor market.

In regards to growth, past CBO reports have recommended investments in transportation and infrastructure, while your observations regarding the changing labor market and the need to equip our workforce with 21st century skills, and to do this implies a need for investment in education. So can you explain to this committee how public investments in education, transportation, and infrastructure promotes economic growth?

Mr. ELMENDORF. Yes, first, to clarify, we have not recommended any policies. That is not in our charter. We have analyzed the effects of policies.

Mr. HONDA. Right.

Mr. ELMENDORF. And we have said that—for example, we released a report at the end of last year about the transportation and water infrastructure of the United States. We in this case cited analysis by other people, other organizations, that there are additional highway spending, if used on the projects with greatest economic return, would have economic return that exceeded their costs. That doesn't—and other sorts of investments, like education, can again, if effective, can enhance future economic output.

I think the key, and this is a big issue as you know in the infrastructure discussion, is how to direct the money to a place, to certain sorts of projects that have high returns.

Mr. HONDA. One of the high returns is not only job creation but public safety, and we can see what happened in Minnesota when we don't keep up with our obligations.

So it appears to me that the return on our investment is high and would be positive to our economic growth.

Thank you.

Mr. MCCLINTOCK. Mr. Flores.

Mr. FLORES. Thank you, Mr. Chairman.

Dr. Elmendorf, thank you for joining us today. You and your team have the unenviable task of taking the projected policy impact on human behavior and organizational behavior and trying to convert that to numbers. So I appreciate your efforts to try to do that.

But with that said, I think we can all agree that it is somewhat, even though you do your best, it can be somewhat subjective.

And with that, one of the things that I am going to ask you to keep in mind as we go forward is that we are marching off in uncharted territory as a country with high debt levels, and so the old

models may not apply as we go forward. I am sure there will be times when we will talk about that as we go forward.

My first question, how much has the Federal debt grown in the last three fiscal year? It is over $4 trillion, right?

Mr. ELMENDORF. Yes.

Mr. FLORES. There has been some commentary during this hearing extolling the virtues of PAYGO. In my view, growing our debt by $4 trillion while PAYGO was in operation would indicate that PAYGO has been an abject failure.

The next thing I want to talk about is, you said earlier in your testimony, not only today but earlier, that you don't get a good bang for the buck in terms of reducing taxes on the economy. Where do you get the bang for the buck?

Mr. ELMENDORF. Actually, I don't think that is a fair characterization of what we said.

Mr. FLORES. Maybe I heard it wrong. I want to make sure I heard it correctly.

Mr. ELMENDORF. The short term stimulative effect on the economy in a weak economy, like ours is today, depends very importantly on the nature of a spending or tax change. So, in fact, in our analysis, the highest bang for the buck was increasing aid to the unemployed. But the next three options ranked on our list were different ways of reducing employers' payroll taxes.

So the methodology that we use does not have an intrinsic tax-versus-spending hierarchy. It is the nature of the policy. The payroll tax we think would be more effective than an across-the-board tax cut of the sort I was asked about earlier because more of the money is directed at people who have less savings and are likely to spend the larger share of the extra income that they receive.

Mr. FLORES. Okay, well, that is helpful, because the way I heard it originally, it was in contravention with what Christina Romer, who is the former chair of the President's economic team, who said at one time that the best economic—the best bang in terms of economic—the best bang for the buck in terms of increased economic activity was due to reducing taxes.

How many jobs did the CBO estimate were created under stimulus spending?

Mr. ELMENDORF. So we estimated—I have it here. Our latest estimate is that employment in 2010 was between 1and a quarter and 3 and a quarter million higher than it would have been in the absence of that legislation.

Mr. FLORES. So that would indicate we spent, for every job created, you assume we spend $800 billion, that it cost $6 billion a job; is that correct?

Mr. ELMENDORF. No, no. The mid point in this range I describe was 2 and a quarter million jobs.

Mr. FLORES. So a little less than $4 million a job is what it cost? Did I do my math right; $400,000 a job?

Mr. ELMENDORF. I am sorry, I don't know that number.

Mr. FLORES. We ought to calculate it. I think the bottom line is that stimulus spending is not a very efficient way to create jobs. If we run the math, whether it is $400,000 or $4 million, and I may have my math wrong, too, but that is a very inefficient way to create jobs. I think that the economic models will show that changes

in tax policy have a much bigger impact on economic growth than do changes in Federal spending.

Thank you.

Mr. MCCLINTOCK. Ms. Wasserman Schultz.

Ms. WASSERMAN SCHULTZ. Thank you so much.

Mr. Elmendorf, I want to ask you some questions. It actually is a perfect counterpoint to Mr. Flores's comments because I think he is exactly wrong in terms of both his explanation related to the Recovery Act and its impact as well as what are the policies that provide us with the biggest bang for our buck.

Tax cuts certainly provide a certain bang for the buck, but my understanding in just reading a lot about how to recover from the recession and the best economic policies is that among the biggest bang for our buck is not so much tax cuts but providing additional funds directly into the hands of low-income households; things like that, like unemployment compensation and other policies that put money directly into the hands of people who really need to use that money and can't really afford to sit on it. Am I right?

Mr. ELMENDORF. You are right, Congresswoman. In terms of the short-term stimulative effect of a policy, what matters most is whether the money gets spent. And giving it to lower-income people tends to lead to a larger share of the money being spent. Whether that is done on the spending side or the tax side is less important than who the money goes to.

Ms. WASSERMAN SCHULTZ. Just by way of comparison, would you say that unemployment compensation, a payroll tax holiday, other kinds of policies that put money directly into the hands of lower-income individuals, would provide more bang for the buck for the economy than let's say tax cuts for the wealthiest individuals?

Mr. ELMENDORF. In terms of the short-run economic stimulus, yes, Congresswoman.

Ms. WASSERMAN SCHULTZ. Thank you.

And just on the Recovery Act itself, according to CBO's models, my understanding is that the Recovery Act increased employment in 2010 by somewhere between—and I think this is CBO's estimate—1.3 million and 3.3 million people. Is that right?

Mr. ELMENDORF. That is right.

Ms. WASSERMAN SCHULTZ. Yesterday, Chairman Bernanke was here, and he testified on the state of the economy. He has previously observed that with the remainder of the Recovery Act funds set to expire—or not expire but to be spent this year and then no longer be available to State and local governments, the expiration, for lack of a better term, of the stimulus funds is obviously going to worsen the outlook—my State is facing a $3.6 billion deficit, will no longer have the stimulus funds available after the end of this year—and that would present a headwinds for the overall economy. Can you give us a sense of whether you agree with his assessment?

Mr. ELMENDORF. Yes, I think that is right, that the waning effects of the Recovery Act represent a drag on economic growth over the next year or so.

Ms. WASSERMAN SCHULTZ. So that fact, coupled with draconian cuts proposed, for example, in Chairman Ryan's plan, which is like an anti-Recovery Act, would you give us a sense whether you think large spending cuts like that right away would be an additional

drain on economic growth, especially when compounded with the expiration of the Recovery Act funds?

Mr. ELMENDORF. So our analysis, yes, implies that cutbacks in government spending under current economic conditions tend to reduce output employment in the short term. And the issue that you and your colleagues face is how to balance that against the other problems that arise from the burgeoning national debt.

Ms. WASSERMAN SCHULTZ. So potentially if we cut too much too quick and we have the expiration of the Recovery Act funds, with the State and local governments facing significant deficits to start with, couldn't we endanger the recovery?

Mr. ELMENDORF. Well, it could slow the recovery. Endangering I think depends on the overall scale of the activity.

Ms. WASSERMAN SCHULTZ. Let me rephrase. Obviously, the recovery has not been as quick as we would like. Isn't it likely that the combination of all of those things would result in the recovery slowing as opposed to quickening?

Mr. ELMENDORF. Yes. I mean, our forecast, of course, builds in the things that are in current law. And additional cuts in spending in the near term we think would have some dampening effect on output and employment, and the magnitude depends on the magnitude of the cuts.

Ms. WASSERMAN SCHULTZ. Thank you very much.

Chairman RYAN [presiding]. Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman.

Dr. Elmendorf, I apologize. I am going to move very quickly because I have an additional topic I want to talk to you about. If I could bring the first draft up, that would be fantastic.

A quick question, can you have a deficit without spending? You can't, can you?

Mr. ELMENDORF. No, Congressman. You can't.

Mr. MULVANEY. This is a graph of the historical revenues and spending levels as a percent of GDP going back to 1960. I have heard some discussion today that suggests that we don't have a spending problem, that we have a spending problem and a revenue problem. It looks like historical revenues have averaged about 18 percent of GDP over the course of the last 40 years, and spending has been about 20.

Take a look, Doctor, back in the 1960s, it looks like we were taking in about 18 percent in terms of revenues, percent of GDP. Do you remember what the top marginal rate was back then?

Mr. ELMENDORF. It was quite high.

Mr. MULVANEY. So even then, and I think it was above 90 at that point, even then we weren't able to squeeze more than 18 percent of GDP out in terms of revenue. So we are were soaking it to the rich pretty good. But we couldn't get much above 18. In fact, the only time we have gone above 20 was during the dot-com boom of the late 1990s, early 2000s.

Now it looks like, according to your projections, because these are your projections, we do get revenues back at historically high levels in the next 10 years, that we get revenues back to 20 percent of GDP, and we still have a dramatic deficit in those years, don't we, sir?

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

Mr. MULVANEY. And that is because our spending is way above our historical average of 20 percent, correct?

Mr. ELMENDORF. That is right, Congressman.

Mr. MULVANEY. If I can bring up the second graph.

I asked my staff to come up with something that has been bugging me since I have been here. This is my own personal idea of what a tipping point is. I asked them to graph the projections using your numbers of the total revenues that the government expects to take in versus the interest payment obligations. Now the top graph is I think what you call your extended baseline, but the bottom one is the alternative fiscal that I think folks around here tell me is what we use traditionally. Do you see what I see, Doctor?

Mr. ELMENDORF. I am not sure what you see, Congressman.

Mr. MULVANEY. In 2055, more than 100 percent of the expected revenues, using CBO numbers, will go to only interest payments. Now, I will tell you that we put this together using your staff, and I would ask you to the extent that a freshman has the opportunity to ask you to do this kind of stuff, to make sure those numbers are right. We worked very closely using your assumptions, and I am confident that they are, but I would be curious if you folks would also take a look at them as well.

This comes back to the original point that I made yesterday with Chairman Bernanke regarding your assumptions on interest rates. If you take a look at the baseline, your all's assumptions for this year on the 10-year treasury, for example, just so we get apples to apples, is 3.4 percent. Last week it traded at 3.5. Yesterday, while Mr. Bernanke was testifying, it traded at 3.7. At what point, sir, would you think it is reasonable for you to go back in and readjust your numbers to take in some more real world considerations on interest rates?

Mr. ELMENDORF. We update our forecasts several times a year, Congressman.

I would emphasize the time that we set this path for interest rates, we set a path that was above the path in financial markets. And we did that because our own modeling suggested that rates seemed to us that they should be higher.

On the other hand, there are a lot of people betting very large sums of money on what is happening in the financial markets, and we thought it was appropriate for us to give weight exactly to the real world considerations that you are highlighting.

Mr. MULVANEY. Clearly, I am not suggesting that your methodology was wrong. I don't think anybody expected a 100 basis point rise in the 10-year Treasury since October, but it certainly is the real world. And I suggest to you, Doctor, am I wrong when I say that higher interest rates will move that red line in the bottom curve further to the left, bringing closer the date at which our debt obligations will exceed our revenues?

Mr. ELMENDORF. That is right, Congressman, and we do show in the appendix to the outlook the effect of alternative assumptions about interest rates, as well as GDP growth and inflation and so on, on the Federal budget.

Mr. MULVANEY. I appreciate that. That was one of the best pieces of the thing that I read, where you all actually went down section by section and said, look, here are our assumptions on GDP; here

are our assumptions on interest rates; if they are off by a percent or a 10th of a percent, here is the output.

By the way, the result, if we have an interest rate that is 1 percentage point higher than your assumptions, we are looking at an additional $1.3 trillion in debt over the course of the next decade.

I am going to ask you to do one last thing. Do you have your report in front of you, sir?

Mr. ELMENDORF. Yes, I do.

Mr. MULVANEY. Would you turn to page 118, please?

Mr. ELMENDORF. Okay.

Mr. MULVANEY. I ask you to read the last sentence beginning "in January," above the title that begins "higher inflation." So it is the last section of the previous section.

Mr. ELMENDORF. "In January 2008, under the laws in effect at that time, CBO projected that debt held by the public would total about $5 trillion by the end of 2018. In CBO's current projections, debt held by the public is close to $16 trillion by the end of 2018 and exceeds $18 trillion by the end of 2021."

Mr. MULVANEY. Thank you, Doctor.

Thank you, Mr. Chairman.

Chairman RYAN. Mr. Tonko.

Mr. TONKO. Thank you, Mr. Chairman.

Dr. Elmendorf, thank you for providing your insights to the committee. I appreciate it.

In January of 2010, did you write a letter to Chairman Ryan concerning the analysis of Chairman Ryan's roadmap?

Mr. ELMENDORF. Yes, we did, Congressman.

Mr. TONKO. And was that letter a formal cost estimate?

Mr. ELMENDORF. No, it was not.

Mr. TONKO. Now with the Ryan roadmap, in addition to restructuring several spending programs, it also puts forward a plan to dramatically restructure our tax system. As I understand it, according to a widely cited analysis by the nonpartisan Tax Policy Center, this plan would cut in half taxes on the richest 1 percent of Americans.

We all know that tax cuts don't pay for themselves, so under this plan, the burden of this high-income tax cuts is then shifted to low- and middle-income families. In fact, according to the Tax Policy Center's analysis, about three-quarters of Americans would see their taxes increase.

I find that drastic middle class tax hike would be insufficient to put the Federal budget on a sustainable path in the next several decades and, in addition, is accompanied by provisions that threaten the health care for seniors and the health care for our most vulnerable populations and plans to gamble Social Security checks on a stock market that we know has not been a friend to retirement accounts in the last few years.

So did your letter do a specific analysis of the tax provisions of this roadmap?

Mr. ELMENDORF. No, Congressman. Because the Joint Tax Committee staff does the estimates in the 10-year window for changes in the Internal Revenue Code, our longer-term modeling focuses on the spending side of the budget. We haven't built the tax side of

the budget. So we were unable to analyze the tax provisions. That is why you don't find that in our letter.

Mr. TONKO. So you did nothing on the tax provisions. So, for the purposes of your analysis, you used an assumption that the overall level of revenues collected would remain the same as they are under current policies through 2030 and would equal some 19 percent of GDP in the later years. Who provided you with that assumption?

Mr. ELMENDORF. We followed the specification from Chairman Ryan and his staff.

Mr. TONKO. So was it the Joint Committee on Taxation that provided that information?

Mr. ELMENDORF. No, they didn't do that analysis.

Mr. TONKO. So all of that assumption and all the guidelines were done by the Chairman?

Chairman RYAN. Would the gentleman yield?

Mr. Tonko, I can answer your question if you would like. You are asking the wrong guy.

Mr. ELMENDORF. So, Congressman, we didn't have the capacity to model that part of the roadmap.

In order to take the parts that we could model on the spending side and show how the pieces fit together, we followed and were very explicit in the letter that we just followed the policy as it was described to us by the Chairman.

Chairman RYAN. If the gentleman would yield, where we got our revenue estimates from were the Office of Tax Analysis at the Treasury Department. Joint Tax could not give us estimates, so we went to the next best source using the same model that Joint Tax uses to try and hit our revenue targets, which were to get to historic revenue levels.

So our tax reform levels were set at what Joint Tax—at what OTA told us would hit us at revenue target levels. And that is how we got that level.

Mr. TONKO. And it is why Dr. Elmendorf then said that it was you, Mr. Chairman, and your staff that provided that information?

Chairman RYAN. Yes.

Mr. TONKO. Now, the Tax Policy Center analysis, unsurprisingly, finds that with a radical restructuring of our tax system comes a radical change in the amount of revenues collected.

We have heard many claims circulating this year that the bottom 50 percent of Americans don't pay their fair share of taxes under our current system.

Well, as of 2007, the bottom 50 percent of households in America, I am informed, hold just 2.5 percent of this Nation's wealth. And according to the claims of my Republican colleagues, they pay 3 percent of the taxes. That sounds to me like they are paying more than their fair share. And I would like your response to that.

Mr. ELMENDORF. I don't have wealth numbers at hand.

We did testimony before the Senate Finance Committee in December that presented information on the evolution of marginal tax rates over time, as was mentioned earlier, and on the distribution of the tax burden.

The Federal tax burden is higher as a share of income on higher-income people. Thus, the after-tax distribution of income is slightly

less unequal than the before-tax distribution of income, but it is still——

Mr. TONKO. A burden.

Mr. ELMENDORF. Quite unequal. If it is the right burden is up to you and your colleagues.

Mr. TONKO. Thank you very much.

Chairman RYAN. Mr. Ribble.

Mr. RIBBLE. Dr. Elmendorf, thank you for being here today. I have enjoyed listening to the conversation quite a bit, and I have especially enjoyed your testimony today.

Mr. ELMENDORF. Thank you.

Mr. RIBBLE. I can tell you, I have only been here a little over a month, and I have heard quite a bit just this morning that the Democrats did this and the Republicans did that, and it is their fault, and it is our fault, and it is everybody's fault. I have to tell you something, my grandkids don't care much about that. They care about what the future looks like.

Do you believe when my grandson hits 20 in 2021, that $18 trillion debt makes his future more bright or less bright than a debt that would be lower than that?

Mr. ELMENDORF. It makes his future less bright, Congressman.

Mr. RIBBLE. Okay, that is what I thought. That is why I am here.

I have also heard that our debt and our deficit and our spending is on an unsustainable trajectory. I have heard that probably a hundred times since I have been here. You used the word "unsupportable." What level of debt and deficit spending would you consider supportable?

Mr. ELMENDORF. Well, as we have said in this report and other places, we don't know if there is a tipping point. And we don't know where that tipping point might be. It depends not just on the level of outstanding debt but also on people's perceptions of where the debt is heading, what current policies will lead to in the future, and on the willingness of you and your colleagues to make changes in policy. So I don't want to pick a particular number.

One criterion, though, for sustainable policy is that debt cannot continue to increase relative to the size of the economy. So the upward trajectory that we show, especially under this continuation of current policy scenario, is not sustainable because debt cannot continue to rise indefinitely relative to GDP.

Mr. RIBBLE. So, your words, I think these were your words, maybe I am paraphrasing here, that delaying our efforts to fix this problem would be bad?

Mr. ELMENDORF. Delaying—we don't make policy recommendations, Congressman.

What we have said very clearly is that delay increases the costs of the burgeoning debt, and it increases the drain on the future incomes, like your grandchildren.

It increases the ultimate spending cuts or tax increases that will be needed to put the budget on a sustainable path. It reduces the flexibility that you and your colleagues have in dealing with unexpected problems in this country or overseas, and it raises the risk of a fiscal crisis.

Mr. RIBBLE. So the longer we wait, the more difficult the fix is going to become in terms of how harshly we must cut or draw back?

Mr. ELMENDORF. That is right, Congressman.

We have a study we released in the fall about the cost of waiting, the impact of delaying efforts to address the fiscal imbalance.

Mr. RIBBLE. And then, along with that, and I realize you don't make policy suggestions here, but I am assuming that at some point, this Congress, I would hope it would be this Congress or some very soon future Congress, is going to have to address the issue of entitlement spending, aren't we, that we can't find a place without that?

Mr. ELMENDORF. "Can't" is a strong word for me, Congressman.

There are countries—there are functioning economies with fairly high standards of living that have government programs much more expansive than ours and tax burdens that are higher. They give something up through having made that set of choices. But I don't want to presume, as the Chairman noted, it is not my place to invoke my policy preferences. That is for you and your colleagues.

Mr. RIBBLE. Sure.

Very good. Thank you, Doctor.

Mr. ELMENDORF. Thank you, Congressman.

Chairman RYAN. Ms. Bass.

Ms. BASS. Thank you, Mr. Chairman.

You might have addressed this while I was running to another hearing, but just in case you didn't, if you could talk about the implications with States, especially if we don't raise the debt ceiling, what is the forecast as to what would happen there, and then how would the States be able to meet their obligations? Would we still be able to send States monies? How would we be able to deal with that?

Mr. ELMENDORF. So if the debt ceiling is not raised before the government runs out of money, then not all of the government's obligations would get paid. I don't know which ones might or might not get paid.

Ms. BASS. You don't know how it would be prioritized?

Mr. ELMENDORF. I don't know how it would be prioritized. Naturally, whoever it is who would not be receiving the checks they would otherwise be receiving will feel that effect. And that could be bondholders. It could be State and local governments. It could be households waiting for benefits, depending on what checks go out and what checks don't. For all of the people who are waiting, it will be a burden. And for some governments or businesses or people perhaps an unsupportable problem.

But it is hard for us to analyze that not knowing what the priorities would be and also not ever having seen this event occur in modern U.S. history.

Ms. BASS. In terms of the cuts and knowing that we do have to cut back spending and knowing that we also have to figure out what we do with raising the debt ceiling, where are ways that we can cut that won't hurt the economy and especially hurt jobs?

Mr. ELMENDORF. So, I think, Congresswoman, there aren't a lot of easy ways for you to do this or you and your colleagues who worry about the rising debt would have done those things already.

I think from an economic point of view, what is beneficial for the economy is lower debt accumulation over time, and what can be beneficial now is greater confidence that policies are being changed in ways that will reduce the growth and level of debt.

At the same time, cutting back spending now, raising taxes now will by itself, as I said in response to a number of questions, tend to slow the economy.

So you and your colleagues face a difficult trade-off there, and that is one of the major problems that we and others have discussed in connection with rising debt is that it reduces the flexibility that you have to make policy adjustments that you want.

Countries that get forced—end up in fiscal crises have to make often very stark changes in spending and revenues, often under bad economic circumstances.

Early action by you and your colleagues can help to forestall that possibility in this country. But again, the immediate direct effect of cuts in spending or increases in taxes would be to slow the economy, in our estimation.

Ms. BASS. Thank you.

Chairman RYAN. Ms. Castor.

Ms. CASTOR. Thank you, Mr. Chairman.

And welcome, Director Elmendorf.

You can see policymakers and budget writers have a real balancing act. We have a real balancing act on our hands, and I think both sides of the aisle agree that we have to have a very bold plan on reducing the debt and deficit. We agree that government must live within its means.

Then, on the other hand, I think we all agree that we have got to continue to foster job growth. And when you look at the public surveys, any public survey from across the country, job growth and jobs continues to be the number one priority from the American people. It certainly is in my home State of Florida, in my community, where we still have a double digit unemployment rate.

So I appreciate your expert analysis and guidance on how we walk that tightrope and effect a balancing act, but it appears that a consensus is building for our way forward here. I want to see if you agree with some of the statements that have made by a number of groups that have studied the issue of debt reduction and job creation as well.

The President's bipartisan fiscal commission has recommended that when we are developing our debt reduction plan, that budget cuts should start gradually so they don't interfere with the ongoing economic recovery because growth is essential to restoring fiscal strength and balance. Do you agree with that general approach?

Mr. ELMENDORF. So, Congresswoman, as you know, we don't make recommendations. So sentences that involved the word "should" are sentences that we stay away from, for a good reason.

As you say, you and your colleagues face a trade-off here. Delay in changing the path of fiscal policy has a collection of very serious negative consequences for the economy. At the same time, sharp changes in policy, as I said in my opening remarks, could be dis-

ruptive, and there is a case for giving households and businesses and State and local governments time to plan and adjust. And those sets of ideas are in some conflict, that they push desirable policy in different directions, and we are just not in a position to judge those trade-offs.

I think one thing to emphasize, though, is I don't think there is much of a case for delaying the enactment of policy changes.

Ms. CASTOR. Right. Clearly, we have to get started.

Mr. ELMENDORF. The issue here is the actual collection of more revenue and reduction in spending.

Enactment of changes doesn't cause a near-term contractionary effect and can be supportive of spending if households and businesses gain confidence in seeing the Federal budget on a more sustainable trajectory.

There is really no case that I know of, an economic case, for waiting for you and your colleagues to make decisions. There is an economic case with trade-offs for the pace at which those decisions affect policy.

Ms. CASTOR. I think we agree. I think too often in Washington we focus on where we differ. But I think there is great consensus building that we have got to act now. We have to focus on debt reduction and job creation, and we are going to have this very robust debate about how we get there.

Now yesterday, Chairman Bernanke said the largest drivers of the debt and deficit are health care costs of government and the aging population. Do you agree with that?

Mr. ELMENDORF. Yes, that is right.

Ms. CASTOR. Well, what I hope is, we are starting to see some appropriations cuts coming out from the other side, and I would just caution my colleagues that if the biggest drivers of the debt and deficit are health care costs of government and the aging population, some of the cuts that I am seeing coming out from the Appropriations Committee are not targeted toward the real drivers of the debt and deficit. We have got to work together to get to that point where we are tackling the real problem and not harming job growth.

Another well known economist has said, has recommended to us that you can't do it all right up front. You can't—that it really would push unemployment back to double digits if you try to have trillion dollar cuts in your first 2 years when the better approach is to have a long-term deficit and debt reduction plan. What is your opinion on that?

Mr. ELMENDORF. Again, I think from an economic perspective, the crucial factor for building confidence among American households and businesses and among purchasers of our debt is to have a plan in place, to have a set of policies enacted by the Congress and signed by the President that put the country on a sustainable fiscal trajectory. So I can come up with a report like this that doesn't show debt rising relative to GDP as far as the eye can see. And again, the pace at which those changes are put in place in terms of the unfolding of the policies involves a more complicated trade-off.

Ms. CASTOR. Thank you very much.

Chairman RYAN. Dr. Elmendorf, thank you for spending your morning with us. We appreciate it. We look forward to many more times with you. Thank you.

This hearing is adjourned.

Mr. ELMENDORF. Thank you, Mr. Chairman.

[Questions submitted for the record and their responses follow:]

QUESTIONS SUBMITTED FOR THE RECORD BY MR. HONDA

FRAMING THE QUESTIONS

We all agree that the trajectories of our national deficit and debt are unsustainable, that they place our nation's future in grave peril and that it is this committee's responsibility to make this right for the American people.

1. AFGHANISTAN & TAX CUTS

The only way we can do this is if we are honest about what has placed us in this predicament. Republicans place the blame entirely on Social Security, Medicare and discretionary spending which provide for our working families and their parents in their old age.

They want us to ignore that two policies of the Republican Party—the Bush Tax Cuts and the wars in Iraq and Afghanistan—accounted for over 500 billion dollars of the 2009 deficit and including interest will account for almost 7 trillion dollar over the next decade.

So my question for you is this:

Would the savings that resulted from ending combat operations in Iraq and Afghanistan and allowing the Bush Tax Cuts for the wealthy to expire reduce projected deficits?

2. INVESTING IN EDUCATION AND INFRASTRUCTURE

In your testimony you highlighted the jobs crisis that continues to confront working and middle class families. You cited two culprits: the anemic growth rate and structural changes in the labor market.

In regards to growth, past CBO reports have recommended investments in transportation and infrastructure; while your observations regarding the changing labor market, and the need to equip our workforce with 21st century skills, implies the need for investment in education.

Can you explain for the Committee how public investments in education, transportation and infrastructure promote economic growth?

DR. ELMENDORF'S RESPONSES TO MR. HONDA'S QUESTIONS

This is the response of the Congressional Budget Office to questions for the record asked by the Honorable Michael Honda after a hearing by the House Budget Committee on February 10, 2011.

Q: Would the savings that resulted from ending combat operations in Iraq and Afghanistan and allowing the Bush Tax Cuts for the wealthy to expire reduce projected deficits?

A: SPENDING FOR OPERATIONS IN AFGHANISTAN AND IRAQ

The Congressional Budget Office's (CBO) projections of discretionary spending for the next 10 years include outlays for operations in Afghanistan and Iraq and other potential overseas contingency operations. Specifically, the outlays projected in the baseline come from budget authority provided for those purposes in 2010 and earlier years; the budget authority provided for 2011 under the Continuing Appropriations and Surface Transportation Extensions Act, 2011 (P.L. 111-322) at an annual rate of $159 billion; and the $1.8 trillion in appropriations projected for the 2012-2021 period (under the assumption that annual funding is set at $159 billion plus adjustments for anticipated inflation, in accordance with the rules that govern CBO's baseline projections).

In coming years, the funding required for war-related activities could be smaller than the amounts in the baseline if the number of deployed troops and the pace of operations diminish. To illustrate the potential impact on discretionary outlays that would result from such a decline, CBO formulated a budget scenario that assumes a reduction in the deployment of U.S. forces abroad for military actions. In 2010, CBO estimates, the number of U.S. active-duty, reserve, and National Guard per-

sonnel deployed for war-related activities averaged about 215,000. Under the alternative scenario, the average number of military personnel deployed for war-related purposes would decline over five years: from 180,000 in 2011 to 130,000 in 2012, 100,000 in 2013, 65,000 in 2014, and 45,000 in 2015 and thereafter. (Those numbers could represent various allocations among Afghanistan, Iraq, and other countries.) Under that scenario, total discretionary budget authority for the period from 2012 through 2021 would be $1.3 trillion less than the amount in CBO's current baseline. Assuming that funding is not spent for other purposes, outlays would be lower by $1.1 trillion over that same period.

Many other scenarios and estimated savings in discretionary spending are possible depending on the pace of decline in the number of military personnel deployed for war-related purposes.

REVENUE IMPLICATIONS OF EXTENDING TAX CUTS

CBO's projection of revenues for the next 10 years is intended to show what would happen to revenues if current law remains unchanged. Thus, under the rules that govern CBO's baseline, all provisions of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 tax act) are assumed to expire as scheduled over the next two years.

If the tax provisions of the 2010 tax act that were originally enacted in 2001, 2003, and 2009, were extended, total revenues would be $2.5 trillion lower than total revenues in CBO's baseline projection over the 2012-2021 period, according to preliminary estimates by CBO and the staff of the Joint Committee on Taxation. That estimates includes increases in outlays for refundable tax credits.

If only the tax provisions of the 2010 tax act that were originally enacted in 2001, 2003, and 2009, and that applied to married couples with income below $250,000 and singles with income below $200,000 were extended—as the President has proposed—the revenue reduction would be smaller. While neither the Joint Committee nor CBO has estimated the cost of partial extension (for all but high-income taxpayers) of those tax provisions of the 2010 tax act over the 2012-2021 period, past estimates of that option suggest that it would reduce revenues by about $700 billion less over ten years than full extension.

Q: Can you explain for the Committee how public investments in education, transportation and infrastructure promote economic growth?

A: Spending by the federal government and state and local governments on education, transportation, and other infrastructure can promote economic growth by increasing the amount of productive physical and human capital in the economy. Public spending on education promotes growth when it raises the skill level of the nation's workforce because workers with higher skills are better able to perform their tasks, to solve problems, and to embrace the latest production techniques. Public spending on transportation and other infrastructure can increase economic output by raising the stock of physical capital in the economy, thereby increasing the productivity of labor and other factors of production in the private sector. For example, increasing the amount of transportation infrastructure makes it easier to get materials and labor to production facilities and finished goods to consumers. Consequently, workers can produce and deliver more in a given time and at a given transportation cost. Even so, funds spent for those purposes cannot be spent elsewhere in the economy; leaving more money in the hands of the private sector by instead reducing borrowing or lowering taxes can also promote growth.

The roles of the federal government and state and local governments vary widely in spending for education, transportation, and other types of infrastructure. In particular:

- In federal fiscal year 2007, the most recent year for which data on combined spending by the federal government and by state and local governments are available, total public spending for education was approximately $852 billion (in 2009 dollars). (That figure excludes spending for formal and informal training programs that are not school-based.) Spending by state and local governments accounts for over 90 percent of that total; the $63 billion spent by the federal government accounts for the remaining share of public spending. In addition to that public total, the private sector spends hundreds of billions of dollars per year on private colleges and universities and on private primary and secondary education.
- In federal fiscal year 2007, the most recent year for which data on combined spending by the federal government and by state and local governments are available, total public spending for transportation infrastructure was approximately $247 billion (in 2009 dollars). (The private sector plays a small role in the provision of transportation infrastructure and those expenditures are essentially confined to spending on freight rail and aviation.) The federal government accounts for over

one-quarter of public spending on transportation infrastructure with state and local governments accounting for the rest. Spending on highways amounted to almost two-thirds of public spending on transportation infrastructure; virtually all federal outlays went to highway construction while state and local expenditures went to both construction and maintenance.

- Total public spending on water infrastructure, defined as water resources (such as dams and levees), water supply systems, and wastewater treatment plants, was $110 billion in 2007. Spending for water supply and wastewater treatment was $101 billion, or over nine-tenths of public spending on water infrastructure. State and local governments accounted for almost all of that spending; about one-third of the expenditures by those governments was for building new infrastructure and two-thirds was for the operation and maintenance of that existing infrastructure. Data on spending by state and local governments for water resources are not available.

The effect of spending for education, transportation, and other infrastructure on economic growth is imprecisely measured and is not easily generalized. The impact of public investments in education on economic growth depends both on the nature of those investments and on the production technologies and levels of capital (both physical and human) that currently exist in the economy. For example, investments aimed at helping young adults complete college may produce returns fairly quickly, but which are ultimately less than the longer-term benefits from investments to improve the learning abilities of pre-school or elementary-school aged children. Further, raising the skills of the least able workers may have different effects on economic growth than raising the skills of more skilled workers, and those effects may depend on the technology and physical capital in use at the time (i.e., training skilled workers to use sophisticated equipment will have only a small payoff if there are only few such machines available). Finally, it is difficult to accurately measure the level of and changes in the productive skill-level of the workforce—the most common measure, years of schooling, is useful but only an approximate measure of skill. Ultimately, public investments in education that raise the skills of the workforce should contribute to economic growth, but the returns to those investments cannot be forecast with any confidence. The economic research on the payoff to transportation and other infrastructure spending generally shows that such investment yields positive returns; however, there is significant variation in the average return both across different periods of time (especially for highways) and across individual projects at a given moment in time. As a result, identifying economically justifiable projects—those with benefits to society that are expected to outweigh costs—is crucial for realizing the potential gains from public spending for infrastructure.

[Whereupon, at 11:58 a.m., the committee was adjourned.]