THE CONGRESSIONAL BUDGET OFFICE'S LONG-TERM BUDGET OUTLOOK

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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THE CONGRESSIONAL BUDGET OFFICE'S LONG–TERM BUDGET OUTLOOK

THURSDAY, JUNE 23, 2011

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

The Committee met, pursuant to call, at 10:00 a.m., in room 210, Cannon House Office Building, Hon. Paul Ryan, [Chairman of the Committee] presiding.

Present: Representatives Ryan, Garrett, Price, Stutzman, Black, Ribble, Flores, Huelskamp, Amash, Woodall, Schwartz, Doggett, Blumenauer, Yarmuth, Pascrell, Wasserman Schultz, Tonko, Bass.

Chairman RYAN. Welcome all to this very important hearing. The purpose of our hearing today is to discuss what can be done to avoid a debt-fueled economic collapse in this country. Our witness today is Doug Elmendorf, Director of the Congressional Budget Office. I want to thank you Doug for your professionalism and your hard work and those of our associates at CBO, and for appearing before our committee yet again today.

Yesterday the CBO released its long-term budget outlook. This report throws harsh light on the challenges we face and it sounds an alarm that too many in Washington have been ignoring for far too long. The federal government will race across a dangerous tipping point this year. According to CBO, total U.S. debt will reach 100 percent of GDP. Our debt will have eclipsed the size of our entire economy.

Economists who have studied sovereign debt tell us that letting total debt rise above 90 percent of GDP creates a drag on economic growth and intensifies the risk of a debt-fueled economic crisis. The CBO is candid about the increasing likelihood of this crisis and the report quotes, "Such a crisis would confront policy makers with extremely difficult choices and probably have a very significant negative impact on the country."

This quote demonstrates CBO's flair for the understatement. A sudden fiscal crisis would be a complete catastrophe for this country. Families and businesses would bear the full brunt of the painful consequences. If the nation ultimately experienced a panic run on its debt, policy makers would be forced to make the immediate and painful fiscal adjustments, like the Austerity Programs that have stoked the riots in Greece. This would mean massive tax increases on working families and steep benefit cuts that hit our most vulnerable citizens the hardest.

The CBO is a non-partisan agency, so it does not take a position on what would be required to prevent this crisis; but we can draw our own conclusions on the evidence in this report. For one thing, this report makes clear that exploding government spending, not insufficient revenue, is driving us toward this crisis point.

If we simply keep revenues at their historic revenue, or average as a share of GDP, then government spending driven by an aging population and rising health care cost will cause federal debt to grow to unsustainable levels. Yet again CBO makes it clear that Medicare and government health care programs are driving the debt; and driving these programs themselves into bankruptcy. Attacking solutions to save these programs threatens both the health security and economic security of the American people. If we try to chase ever higher spending with ever higher taxes, the CBO is very clear about the consequences. It estimates that GNP will be 2 percent lower in 2035 than it would be otherwise. That number represents hundreds of billions in dollars of lost income for American families and businesses on top of much higher taxes they would have to pay.

The House Republicans have passed a budget, the Path to Prosperity; which answers CBO's warnings and averts the crisis before us. The House passed budget tackles the explosive growth in spending. It saves critical programs like Medicare and puts our budget on a path to balance without resorting to job destroying tax hikes. Meanwhile, the president has not put forward a credible plan; a credible budget and it is been 785 days, let me say that again, it has been 785 days since the Senate passed any budget at all.

We have a leadership deficit in Washington, and our window for solutions is closing quickly. Instead of tuning out CBO and others who are working to inform us of this danger, let's work together now before it is too late to put America's budget on a sustainable path, grow the economy, and leave the next generation with a better country than the one we inherited.

Thank you, and with that I would like to yield to Vice Ranking Member, Ms. Schwartz.

[The prepared statement of Chairman Paul Ryan follows:]

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

Welcome all, to this important hearing. The purpose of today's hearing is to discuss what can be done to avoid a debt-fueled economic collapse in this country.

Our witness today is Doug Elmendorf, director of the Congressional Budget Office. I thank you Doug for your professionalism and hard work at the CBO, and for appearing before this committee today.

Yesterday, the CBO released its Long-Term Budget Outlook. This report throws harsh light on the challenges we face, and sounds an alarm that too many in Washington have been ignoring for far too long.

The federal government will race across a dangerous tipping point this year: According to the CBO, total U.S. debt will reach 100 percent of GDP. Our debt will have eclipsed the size of our entire economy.

Economists who have studied sovereign debt tell us that letting total debt rise above 90 percent of GDP creates a drag on economic growth and intensifies the risk of a debt-fueled economic crisis.

The CBO is candid about the increasing likelihood of this crisis, and the report states: "Such a crisis would confront policymakers with extremely difficult choices and probably have a very significant negative impact on the country."

This quote demonstrates the CBO's flair for understatement. A sudden fiscal crisis would be a complete catastrophe for this country. Families and businesses would bear the full brunt of the painful consequences.

If the nation ultimately experienced a panicked run on its debt, policymakers would be forced to make immediate and painful fiscal adjustments, like the austerity program that has provoked riots in Greece. This would mean massive tax increases on working families and steep benefit cuts that hit our most vulnerable citizens the hardest.

The CBO is a non-partisan agency, so it does not take a position on what will be required to prevent this crisis.

But we can draw our own conclusions from the evidence in this report.

For one thing, this report makes clear that exploding government spending, not insufficient tax revenue, is driving us toward this crisis point.

If we simply keep revenues at their historical average as a share of GDP, then government spending—driven by an aging population and rapidly rising health care costs—will cause federal debt to grow to unsustainable levels.

Yet again, CBO makes clear that Medicare and government health care programs are driving the debt—and driving these programs themselves into bankruptcy. Offering empty promises and false attacks instead of real solutions threatens the health and economic security of the American people.

If we try to chase ever-higher spending with ever-higher taxes, the CBO is clear about the consequences: It estimates that GNP would be 2 percent lower in 2035 than it would be otherwise.

That number represents hundreds of billions of dollars in lost income for American families and businesses, on top of the much higher taxes they would all have to pay.

The House of Representatives has passed a budget, The Path to Prosperity, which answers the CBO's warning and averts the crisis before us. The House-passed budget tackles the explosive growth of spending, saves critical programs such as Medicare, and puts our budget on a path to balance—without resorting to job-destroying tax hikes.

Meanwhile, the President still hasn't put forward a credible budget, and it has been 785 days since the Senate passed any budget at all.

We have a leadership deficit in Washington, and our window for solutions is closing quickly.

Instead of tuning out CBO and others who are working to inform us of the danger, let's work together now, before it's too late, to put America's budget on a sustainable path, grow the economy, and leave the next generation with a better country than the one we inherited.

Thank you, and with that, I yield to the Ranking Member, Mr. Van Hollen.

Ms. SCHWARTZ. Thank you Mr. Chairman, and I look forward to this hearing, and not because it will be easy to hear or because it is new, but because it is a reality of what our nation is facing and demands our attention. I did want to say that Ranking Member Mr. Van Hollen is at the White House. He apologizes to Dr. Elmendorf for not being here, but he is working, of course, with the vice president, the White House, the Senate and the Republicans here in the House on the issue of the debt ceiling, which I know we may talk some more about and see if they cannot come to some agreement about a balanced approach of spending cuts and revenue increases to be able to move forward. We will see. We do not know. We will see.

I appreciate the opportunity to just make a few comments about where we stand, what we will hear today and about how we move forward.

For me, and I think many of you know this, I have been on the Budget Committee for some time; the federal budget is a statement of our priorities and our values as a nation. It is about three things: it is about being fiscally responsible and reducing our debt; meeting our obligations to our seniors, our families, and our future; and making target investments to grow our economy. To put our country back on a strong financial footing we need a balanced approach, and that includes spending cuts from every aspect of the budget, smart investments to ensure our economic competitiveness, and fair tax reform that will increase revenue. We do not need just political rhetoric or strict ideology. Everything must be on the table and compromise is critical; finding that common ground is very important.

Democrats are committed to deficit reduction. I feel like I should repeat that, but Democrats are committed to deficit reduction. The CBO's fiscal outlook reinforces the need for action. The question is not, if we reduce the deficit, because we must; it is how?

We need to reduce the deficit, reach primary balance, and begin to repay our debt; and to do so we must do so in a way that does not endanger our current, fragile economic recovery. The consequences of inaction are clear; higher levels of debt, higher interest payments on that debt, drastic tax increases, severe reductions in spending, and economic stagnation or worse.

CBO forecast has surged in the public debt this year that will rise to 69 percent of GDP by the end of fiscal year 2011. This short-term deficit was made worse by the deep economic recession we have just been through and our necessary response to it, as well as reduced revenues from the Bush tax cuts and increased costs of two unfinanced wars and unpaid-for spending in Medicare Part D.

In the long-term, the deficit is made worse by dramatic changes in demographics in this country; I believe the CBO is going to point this out in particular. Our population is aging 50 million more Americans over 65 years in the next decade. The ratio of workers to retirees moved from three to one, to two to one in the next 40 years, meaning fewer wage earners to support cost of government and the cost of retirees.

Debt is projected by CBO to rise to 84 percent or as much as 187 percent of GDP by 2035. This is simply unsustainable. A long-term balanced deficit reduction plan is absolutely necessary. The president's Fiscal Commission, Erskine Bowles-Alan Simpson Commission, as it is referred to, and the Bipartisan Policy Center, the Domenici-Rivlin which it is often referred to, both strongly acknowledge the need to do both cutting spending and raising revenue. And the Democrats' proposed budget for fiscal 2012 tackles the deficit responsibly by both spending cuts and revenue increases. These include reductions from elimination of duplicative spending, fraud, waste, and abuse; streamlining government to make it more efficient; and eliminating or reducing programs that do not work while protecting those that are vital to the nation. It includes the implementation of health care reform to save $1.2 trillion in health costs over 20 years; and it increases revenue by ending tax cuts for the very wealthiest Americans, saving $800 billion over the years; and ending corporate tax breaks that bring in billions more.

And the Democratic budget makes smart, strategic investments in education, innovation, infrastructure, and research and development; which will strengthen our economic competitiveness and promote private sector job growth and expand our economy. This is balanced, fair and responsible approach and it is a clear contrast to the Republican budget.

The Republican budget takes a sledgehammer to non-defense discretionary spending with careless cuts that do not acknowledge the impact on Americans or our recovering economy. The Republican budget jeopardizes food safety, highway expansion; it undermines education and scientific research; and reduces our best hopes for a future prosperity.

Second, the Republican budget ignores defense spending. It is imperative that we meet our commitment to our troops, our military preparedness, and our security as a nation, but the growth in DOD spending has got to be taken into account. It is after all 20 percent of our spending. In the years between fiscal year 2008 and fiscal year 2012 we will spend more on defense than any period in the last 60 years. This includes the Reagan Cold War build-up in the 1980s, Vietnam and Korean wars. As we ask our government agencies to become more efficient, so must the Department of Defense.

Third, the Republican budget undermines our promise to America's seniors. Make no mistake; the Republican budget will end Medicare for seniors. It will not reduce costs by turning Medicare into a voucher program; it will simply shift that burden on to our seniors, and again, I believe we will talk more about that as we go along. The fact is that a Republican plan will actually increase the costs of seniors' health care, and that increase will be an increase borne by individual seniors not by all of us.

CBO estimates the Republican budget will cost a 65-year-old an additional $6,000 in out-of-pocket costs, and by 2030, it could be as high as $12,000. And if Republicans continue their assault on health reform, the cost burden for seniors will not only increase, but it will also reduce coverage and benefits. Going back on the promise that we made to our seniors and disabled in America is wrong. It is not only morally reprehensible, it is fiscally irresponsible.

Finally, fifth, our Republican colleagues refuse to address the need to raise revenue, which is essential to balancing our budget. Just as we cut unnecessary federal spending, we must also cut special tax provisions that add to our deficit. Tax expenditures add over $1 trillion to our deficit annually. Yet, Republicans continue to protect tax breaks for the few. And I will just mention two: the "Big Five" oil companies made $1 trillion in profits in the past 10 years. They are on pace in 2011 to have their most profitable years ever, even as the price of gas at the pump goes up for all of us. Yet, the Republican budget continues to protect billions of dollars in tax breaks every year, for the "Big Five" oil and gas companies. We should stop this and save taxpayers billions. We cannot afford another 10 years of deficit-financed Bush tax cuts and expect our fiscal outlook to change for the better. Revenues must be a part of the solution, plain and simple.

We need sensible, reasonable, and strategic solutions to our nation's budget challenges. It is clear that the House Republican budget takes one-sided approach. We need a balanced approach that meets our commitments to our nation, which is fiscally responsible and will strengthen our economy in the short and the long term. And I look forward to your testimony and the questions and answers.

[The prepared statement of Allyson Schwartz follows:]

PREPARED STATEMENT OF HON. ALLYSON Y. SCHWARTZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Chris Van Hollen is not present at today's hearing because he is at the White House participating in the Biden Budget Talks.

I am looking forward to testimony not because it will be easy to hear or because it is new but because it is the reality of what our nation is facing and what demands our attention

The federal budget is a statement of our priorities and our values as a nation. It is about three things: being fiscally responsible and reducing our deficit, meeting our obligations to our seniors, our families and our future, and making targeted investments to grow our economy.

To put our country back on strong financial footing we need a balanced approach that includes spending cuts from every aspect of the budget, smart investments to ensure our economic competitiveness and fair tax reform that will increase revenue.

We need more just political rhetoric and strict ideology. Everything must be on the table and compromise is critical.

Democrats are committed to deficit reduction. The Congressional Budget Office's fiscal outlook reinforces the need for action. The question is not if we reduce the deficit, because we must, it is how. We need to reduce the deficit, reach primary balance, and begin to repay our debt. We must do so in a way that does not endanger our current fragile economic recovery. The consequences of inaction are clear: higher levels of debt, higher interest payments on that debt, drastic tax increases, severe reductions in spending, and economic stagnation or worse.

CBO forecasts a surge in public debt this year that will rise to 69 percent of GDP by the end of fiscal 2011. This short-term deficit was made worse by the deep economic recession and our necessary response to it, as well as reduced revenues from the Bush tax cuts and increased costs from two unfinanced wars and unpaid-for spending in Medicare Part D.

In the long-term, the deficit is made worse by a dramatic change in demographics in this country: our population is aging with 50 million more Americans over 65 years in the next decade and the ratio of workers to retirees moving from 3:1 to 2:1 in the next 40 years, meaning fewer wage earners to carry the cost of retirees. Debt is projected by CBO to rise to 84% or as much as 187% by GDP by 2035. This is simply unsustainable.

A long-term balanced deficit reduction plan is absolutely necessary. The President's Fiscal Commission (Erskine-Simpson) and the Bipartisan Policy Center (Domenici-Rivlin) strongly acknowledge the need for both cutting spending and raising revenue. The Democrats proposed budget for fiscal 2012 tackles the deficit responsibly with both spending cuts and revenue increases. These cuts include: reductions from elimination of duplicative spending, fraud and waste, streamlining government to make it more efficient, and eliminating or reducing programs that don't work while protecting those that are vital to our nation. It includes the implementation of Health Care Reform to save $1.2 trillion in health costs over 20 years. It increases revenues by ending tax cuts for the wealthiest American saving $800B over years, and ending corporate tax breaks that bring in billions more.

The Democratic budget makes smart, strategic investments in education, innovation, infrastructure, and research and development. These investments will strengthen our economic competitiveness, promote private sector job growth, and expand our economy. This is a balanced, fair, and responsible approach, and it is a clear contrast to the Republican Budget.

First, the Republican budget takes a sledgehammer to non-defense discretionary spending with careless cuts that do not acknowledge the impact on Americans or our recovering economy. The Republican budget jeopardizes food safety and highway expansion; undermine education and scientific research and reduces our best hopes for future prosperity.

Second, the Republican Budget ignores defense spending. It is imperative that we meet our commitment to our troops, our military preparedness, and our security as a nation but the growth in DOD spending has got to be taken into account—It is after all 20 percent of our spending. In the years between FY08 and FY12 we will spend more on defense than any period in the last 60 years. This includes the Regan cold war build-up in the 1980s, Vietnam and Korea Wars. As we ask other government agencies to become more efficient, so must the Department of Defense.

Third, the Republican Budget undermines our promise to America's seniors. Make no mistake; the Republican Budget will end Medicare as we know it for seniors. We will not reduce costs by turning Medicare into a voucher program; it will simply shift that burden on to our seniors. The fact is the Republican plan will actually INCREASE the cost of seniors' health care. This increase that increase will be borne by individual seniors. CBO estimates that the Republican plan will cost a 65 year old an additional $6,000 in out-of-pocket costs. By 2030, it could be as high as $12,000. If Republicans continue their assault on health care reform, the cost burden for seniors will only increase, while coverage and benefits decrease. Going back on the promise we have made to our seniors and disabled Americans is wrong. It is not only morally reprehensible, it is fiscally irresponsible.

Finally, fifth, our Republican colleagues refuse to address the need to raise revenue, which is essential to balancing our nation's budget. Just as we cut unnecessary federal spending, we must also cut special tax provisions that add to our deficit. Tax expenditures add over $1 trillion dollars to our deficit annually. Yet, Republicans continue to protect tax breaks that benefit a few. For example, the "Big Five" oil companies made $1 trillion in profits the past 10 years, and they are on pace for 2011 to be their most profitable year yet. Yet, they continue to receive billions of dollars in tax breaks every year even as the price of gas rises. This should stop and save taxpayers billions. The federal government is also subsidizing the ethanol industry with $6 billion in tax earmarks. We should, as the Senate did, vote to end these tax expenditures. We cannot afford these tax earmarks or another 10 years of deficit-financed Bush tax cuts and expect our fiscal outlook to change for the better. Revenues must be a part of the solution, plain and simple.

In conclusion, we need sensible, responsible and strategic solutions to our nation's budget challenges. It is clear the House Republican budget takes a one-sided approach. We need a balanced approach that meets our commitments as a nation, is fiscally responsible, and will strengthen our economy in the short and long term.

Chairman RYAN. Good. I will just say that we see it a little differently, but Dr. Elmendorf, the time is yours.

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

Mr. ELMENDORF. Thank you Mr. Chairman and Congresswoman Schwartz. To you and all the members of the committee, the budget outlook of the United States is daunting, both during the next decade and over the longer term. As the economy recovers from the severe recession and the policies adopted in response, and as the recession phases out, budget deficits will decline markedly in the next few years. However, the retirement of the Baby Boom Generation portends a significant and sustained increase in the share of the population eligible for Social Security, Medicare, and Medicaid benefits. Moreover, per capita spending for health care will probably continue rising faster than spending and other goods and services.

In addition, the recession and accompanying policies are leaving a legacy of greatly increased government debt. Between the end of fiscal year 2008 and the end of the current fiscal year, debt held by the public will surge from roughly 40 percent of GDP, close to its 40 year average, to nearly 70 percent of GDP: the highest since shortly after World War II. Therefore, we face the budget pressures of an aging population and rising health care costs from a significantly worse starting point than was envisioned just a few years ago. CBO analyzed the long-term budget outlook under two scenarios that embodied different assumptions about future policies. Although there are great uncertainties about future economic conditions, demographic trends, and other factors, we think that the broad implications of our analysis would be the same under reasonable alternative assumptions.

Here are our findings: Under one scenario, our extended baseline scenario, debt held by the public would increase slowly from its already high level relative to GDP, reaching about 85 percent by

2035. That scenario adheres closely to current law; it can be summarized in three broad categories.

First, spending on the major health care programs and Social Security is projected to grow substantially from 10 percent of GDP today to 15 percent 25 years from now. Most of that increase will be for spending on the major health care programs: Medicare, Medicaid, CHIP, and subsidies to be provided through insurance exchanges; which would grow from less than six percent of GDP today to nine percent in 2035. Spending on Social Security is also projected to rise but much less sharply.

Second, in this scenario, given the assumptions that underlie our baseline projections, government spending on everything, other than interest payments on the debt and the programs I have just mentioned, this includes National Defense and a wide array of domestic programs, that category of spending would decline to the lowest share of GDP since before the Second World War.

And third in this scenario, exploration of the tax cuts enacted since 2001, the growing reach of the alternative minimum tax, the tax provisions of last year's health care legislation, and the way in which the tax system interacts with economic growth, would all result in steadily higher revenues. Revenues would reach 23 percent of GDP by 2035, much higher than has been seen in the past. That significant increase in revenues and decrease in the relative amount of other spending would offset much, though not all, of the rise in spending on health care programs and Social Security. So even with revenues at historically high levels, debt would continue to rise.

However, the budget outlook is much bleaker than that under an alternative fiscal scenario, in which federal debt would grow much more rapidly, exceeding 100 percent of GDP by 2021 and approaching 190 percent by 2035. That scenario, which more closely approximates current policies incorporates several changes to current law that are widely expected to occur or that would modify some provisions of law that might be difficult to sustain for a long period.

Most important are the assumptions about revenues, under this scenario we assume that the tax cuts enacted since 2001 will be extended, that the reach of the alternative minimum tax will be restrained, and that over the long run tax law will evolve further so that revenues remain near their historical average of 18 percent of GDP. This scenario also incorporates assumptions about Medicare's payment rates for physicians, that they will remain at current levels rather than declining by a third at the end of this year as under current law, and that some policies enacted last year to restrain growth in health care spending by the federal government will not continue in effect after 2021.

In addition, the alternative scenario includes an assumption that spending on all other activities will not fall quite as low as under the extended baseline scenario; although it will still fall close to its lowest level in the entire post-war period.

It is important to note further that these projections do not incorporate the harmful effects that rising debt would have on economic growth and on interest rates. Incorporating economic feedbacks as we do in the second chapter of the report, debt under this alternative scenario would be well over 200 percent of GDP in 2035, if such a thing could come to pass.

The implications of this analysis are clear, there is a substantial mismatch between what the government would have to spend to maintain existing programs in their current form and the revenues that tax payers are accustomed to providing. To keep deficits in debt from climbing to unsustainable levels, policy makers will need to increase revenues substantially as a percentage of GDP, decrease spending significantly from projected levels, or adopt some combination of those two approaches. Making such changes while economic activity and employment remain well below their potential levels would probably slow the economic recovery. However, the sooner that long-term changes to tax and spending policies are agreed upon, and the sooner they are carried out once the economy recovers, the smaller will be the damage to the economy from growing federal debt. Thank you.

[The prepared statement of Douglas Elmendorf follows:]

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

Chairman Ryan, Congressman Van Hollen, and Members of the Committee, thank you for inviting me to testify today about the Congressional Budget Office's (CBO's) 2011 Long-Term Budget Outlook, which the agency released yesterday.[1]

Recently, the federal government has been recording budget deficits that are the largest as a share of the economy since 1945. Consequently, the amount of federal debt held by the public has surged. At the end of 2008, that debt equaled 40 percent of the nation's annual economic output (a little above the 40-year average of 37 percent). Since then, the has shot upward: By the end of this year, CBO projects, federal debt will reach roughly 70 percent of gross domestic product (GDP)—the highest percentage since shortly after World War II. The sharp rise in debt stems partly from lower tax revenues and higher federal spending related to the recent severe recession. However, the growing debt also reflects an imbalance between spending and revenues that predated the recession.

As the economy continues to recover and the policies adopted to counteract the recession phase out, budget deficits will probably decline markedly in the next few years. But the budget outlook, for both the coming decade and beyond, is daunting. The retirement of the baby-boom generation portends a significant and sustained increase in the share of the population receiving benefits from Social Security, Medicare, and Medicaid. Moreover, per capita spending for health care is likely to continue rising faster than spending per person on other goods and services for many years (although the magnitude of that gap is very uncertain). Without significant changes in government policy, those factors will boost federal outlays sharply relative to GDP in coming decades under any plausible assumptions about future trends in the economy, demographics, and health care costs.

According to CBO's projections, if current laws remained in place, spending on the major mandatory health care programs alone would grow from less than 6 percent of GDP today to about 9 percent in 2035 and would continue to increase thereafter.[2] Spending on Social Security is projected to rise much less sharply, from less than 5 percent of GDP today to about 6 percent in 2030, and then to stabilize at roughly that level. Altogether, the aging of the population and the rising cost of health care would cause spending on the major mandatory health care programs and Social Security to grow from roughly 10 percent of GDP today to about 15 percent of GDP 25 years from now. (By comparison, spending on all of the federal government's programs and activities, excluding interest payments on debt, has averaged about 18.5 percent of GDP over the past 40 years.) That combined increase of roughly 5 percentage points for such spending as a share of the economy is equivalent to about $750 billion today. If lawmakers ultimately modified some provisions of current law

[1] See Congressional Budget Office, CBO's 2011 Long-Term Budget Outlook (June 2011).

[2] Mandatory programs are programs that do not require annual appropriations by the Congress; the major mandatory health care programs consist of Medicare, Medicaid, the Children's Health Insurance Program, and health insurance subsidies that will be provided through the exchanges established by the March 2010 health care legislation.

that might be difficult to sustain for a long period, that increase would be even larger.

LONG-TERM SCENARIOS

In its report released yesterday, CBO presents the long-term budget outlook under two scenarios that embody different assumptions about future policies governing federal revenues and spending. Neither of those scenarios represents a prediction by CBO of what policies will be in effect during the next several decades, and the policies adopted in coming years will surely differ from those assumed for the scenarios. Moreover, even if the assumed policies were adopted, their economic and budgetary consequences would undoubtedly differ from those projected in the report because outcomes also depend on economic conditions, demographic trends, and other factors that are difficult to predict. The report focuses on the next 25 years rather than a longer horizon, because budget projections grow increasingly uncertain as they extend farther into the future.[3]

THE EXTENDED-BASELINE SCENARIO

One long-term budget scenario used in CBO's analysis, the extended-baseline scenario, adheres closely to current law. Under this scenario, the expiration of the tax cuts enacted since 2001 and most recently extended in 2010, the growing reach of the alternative minimum tax, the tax provisions of the recent health care legislation, and the way in which the tax system interacts with economic growth would result in steadily higher revenues relative to GDP. Revenues would reach 23 percent of GDP by 2035—much higher than has typically been seen in recent decades—and would grow to larger percentages thereafter. At the same time, under this scenario, government spending on everything other than the major mandatory health care programs, Social Security, and interest on federal debt—activities such as national defense and a wide variety of domestic programs—would decline to the lowest percentage of GDP since before World War II.

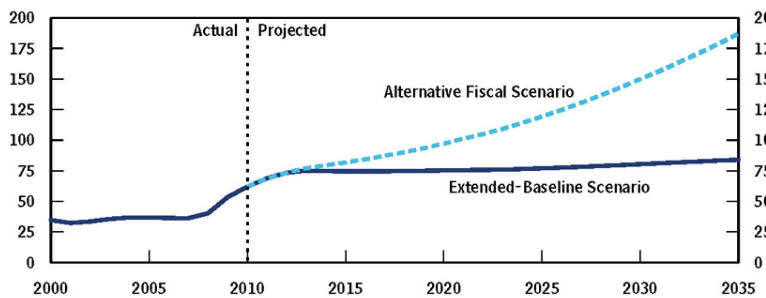
That significant increase in revenues and decrease in the relative magnitude of other spending would offset much—though not all—of the rise in spending on health care programs and Social Security. As a result, debt would increase slowly from its already high levels relative to GDP, as would the required interest payments on that debt. Federal debt held by the public would grow from an estimated 69 percent of GDP this year to 84 percent by 2035 (see Figure 1). With both debt and interest rates rising over time, interest payments, which absorb federal resources that could otherwise be used to pay for government services, would climb to 4 percent of GDP (or one-sixth of federal revenues) by 2035, compared with about 1 percent now.

[3] Because considerable interest exists in the longer-term outlook, figures showing projections through 2085 are presented in Appendix B of CBO's 2011 Long-Term Budget Outlook, and associated data are available on CBO's Web site (*www.cbo.gov*).

Figure 1.

Federal Debt Held by the Public Under CBO's Long-Term Budget Scenarios

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Note: The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period.

THE ALTERNATIVE FISCAL SCENARIO

The budget outlook is much bleaker under the alternative fiscal scenario, which incorporates several changes to current law that are widely expected to occur or that would modify some provisions of law that might be difficult to sustain for a long period. Most important are the assumptions about revenues: that the tax cuts enacted since 2001 and extended most recently in 2010 will be extended; that the reach of the alternative minimum tax will be restrained to stay close to its historical extent; and that over the longer run, tax law will evolve further so that revenues remain near their historical average of 18 percent of GDP. This scenario also incorporates assumptions that Medicare's payment rates for physicians will remain at current levels (rather than declining by about a third, as under current law) and that some policies enacted in the March 2010 health care legislation to restrain growth in federal health care spending will not continue in effect after 2021. In addition, the alternative scenario includes an assumption that spending on activities other than the major mandatory health care programs, Social Security, and interest on the debt will not fall quite as low as under the extended-baseline scenario, although it will still fall to its lowest level (relative to GDP) since before World War II.

Under those policies, federal debt would grow much more rapidly than under the extended-baseline scenario. With significantly lower revenues and higher outlays, debt held by the public would exceed 100 percent of GDP by 2021. After that, the growing imbalance between revenues and spending, combined with spiraling interest payments, would swiftly push debt to higher and higher levels. Debt as a share of GDP would exceed its historical peak of 109 percent by 2023 and would approach 190 percent in 2035 (see Figure 1).

Many budget analysts believe that the alternative fiscal scenario presents a more realistic picture of the nation's underlying fiscal policies than the extended-baseline scenario does. The explosive path of federal debt under the alternative fiscal scenario underscores the need for large and rapid policy changes to put the nation on a sustainable fiscal course.

THE IMPACT OF GROWING DEFICITS AND DEBT

CBO's projections in most of the 2011 Long-Term Budget Outlook understate the severity of the long-term budget problem because they do not incorporate the negative effects that additional federal debt would have on the economy, nor do they include the impact of higher tax rates on people's incentives to work and save. In particular, large budget deficits and growing debt would reduce national saving, leading to higher interest rates, more borrowing from abroad, and less domestic investment—which in turn would lower income growth in the United States. Taking those effects into account, CBO estimates that under the extended-baseline scenario, real (inflation-adjusted) gross national product (GNP) would be reduced slightly by 2025 and by as much as 2 percent by 2035, compared with what it would be under the stable economic environment that underlies most of the projections in the report released yesterday.[4] Under the alternative fiscal scenario, real GNP would be 2 percent to 6 percent lower in 2025, and 7 percent to 18 percent lower in 2035, than under a stable economic environment.

Rising levels of debt also would have other negative consequences that are not incorporated in those estimated effects on output:

- Higher levels of debt imply higher interest payments on that debt, which would eventually require either higher taxes or a reduction in government benefits and services.
- Rising debt would increasingly restrict policymakers' ability to use tax and spending policies to respond to unexpected challenges, such as economic downturns or financial crises. As a result, the effects of such developments on the economy and people's well-being could be worse.
- Growing debt also would increase the probability of a sudden fiscal crisis, during which investors would lose confidence in the government's ability to manage its budget and the government would thereby lose its ability to borrow at affordable rates. Such a crisis would confront policymakers with extremely difficult choices. To restore investors' confidence, policymakers would probably need to enact spending cuts or tax increases more drastic and painful than those that would have been necessary had the adjustments come sooner.

To keep deficits and debt from climbing to unsustainable levels, policymakers will need to increase revenues substantially as a percentage of GDP, decrease spending significantly from projected levels, or adopt some combination of those two approaches. Making such changes while economic activity and employment remain well below their potential levels would probably slow the economic recovery. However, the sooner that medium- and long-term changes to tax and spending policies are agreed on, and the sooner they are carried out once the economy recovers, the smaller will be the damage to the economy from growing federal debt. Earlier action would permit smaller or more gradual changes and would give people more time to adjust to them, but it would require more sacrifices sooner from current older workers and retirees for the benefit of younger workers and future generations.

[4] GNP differs from GDP primarily by including the capital income that residents earn from investments abroad and excluding the capital income that nonresidents earn from domestic investment. In the context of analyzing the impact of growing deficits and debt, GNP is a better measure because projected budget deficits would be partly financed by inflows of capital from other countries.

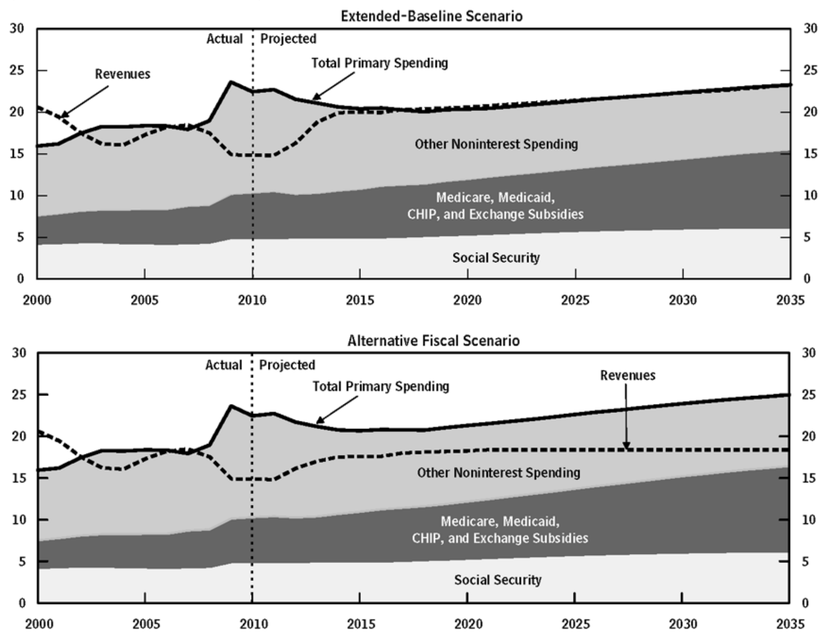
[The complete CBO report may be accessed at the following Internet address:]

http://cbo.gov/ftpdocs/122xx/doc12212/06-21-Long-Term_Budget_Outlook.pdf

Figure 1-1.

Primary Spending and Revenues, by Category, Under CBO's Long-Term Budget Scenarios

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: Primary spending refers to all spending other than interest payments on federal debt.

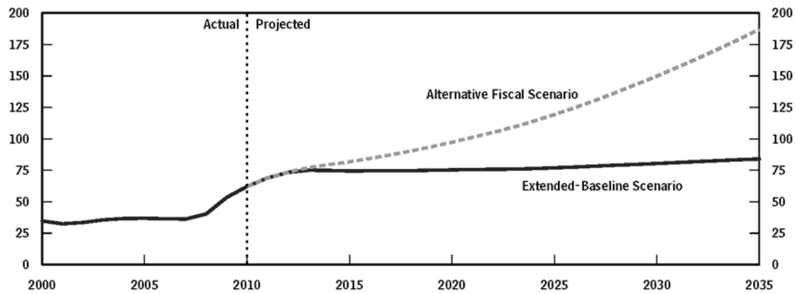
The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

CHIP = Children's Health Insurance Program.

Figure 1-2.

Federal Debt Held by the Public Under CBO's Long-Term Budget Scenarios

(Percentage of gross domestic product)



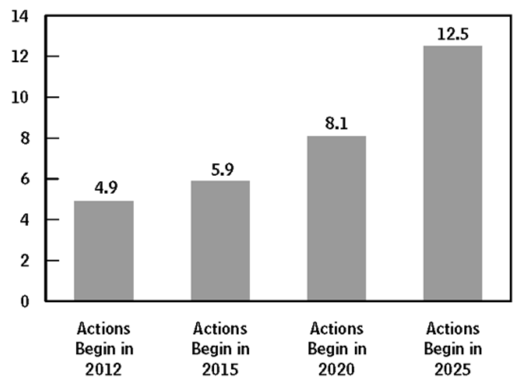
Source: Congressional Budget Office.

Note: The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

Figure 1-3.

Reductions in Primary Spending or Increases in Revenues in Various Years Needed to Close the 25-Year Fiscal Gap Under CBO's Alternative Fiscal Scenario

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: Primary spending refers to all spending other than interest payments on federal debt.

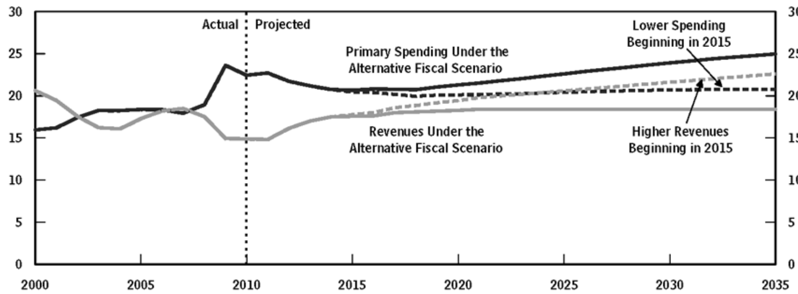
The fiscal gap is a measure of the difference between projected primary spending and revenues over a given period. It represents the extent to which the government would need to immediately and permanently either raise tax revenues or cut spending—or do both, to some degree—to make the government's debt the same size (relative to gross domestic product) at the end of the period that it was at the beginning of 2011.

The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

Figure 1-4.

One Potential Path for Revenues and Noninterest Spending Sufficient to Close the 25-Year Fiscal Gap

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: Primary spending refers to all spending other than interest payments on federal debt.

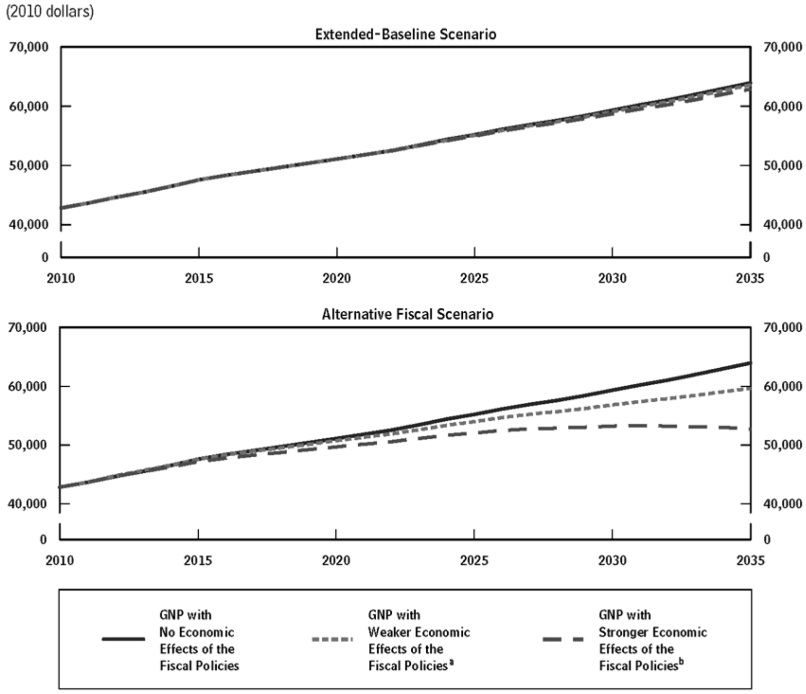
The fiscal gap is a measure of the difference between projected primary spending and revenues over a given period. It represents the extent to which the government would need to immediately and permanently either raise tax revenues or cut spending—or do both, to some degree—to make the government's debt the same size (relative to gross domestic product) at the end of the period that it was at the beginning of 2011.

The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

Figure 2-1.

The Effect of the Fiscal Policies Assumed in CBO's Long-Term Budget Scenarios on Real Gross National Product per Person

(2010 dollars)



Source: Congressional Budget Office.

Notes: The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

The range of estimates shown stems from varying assumptions about how much deficits "crowd out" investment in capital goods such as factories and computers (because a larger portion of people's savings is being used to purchase government securities) and how much people respond to alterations in after-tax wages and interest rates by changing the number of hours they work and the amount they save.

Real (inflation-adjusted) gross national product, or GNP, differs from gross domestic product (the more common measure of the output of the economy) primarily by including the income that U.S. residents earn from their investments abroad and excluding the income that nonresidents earn from their investments in this country.

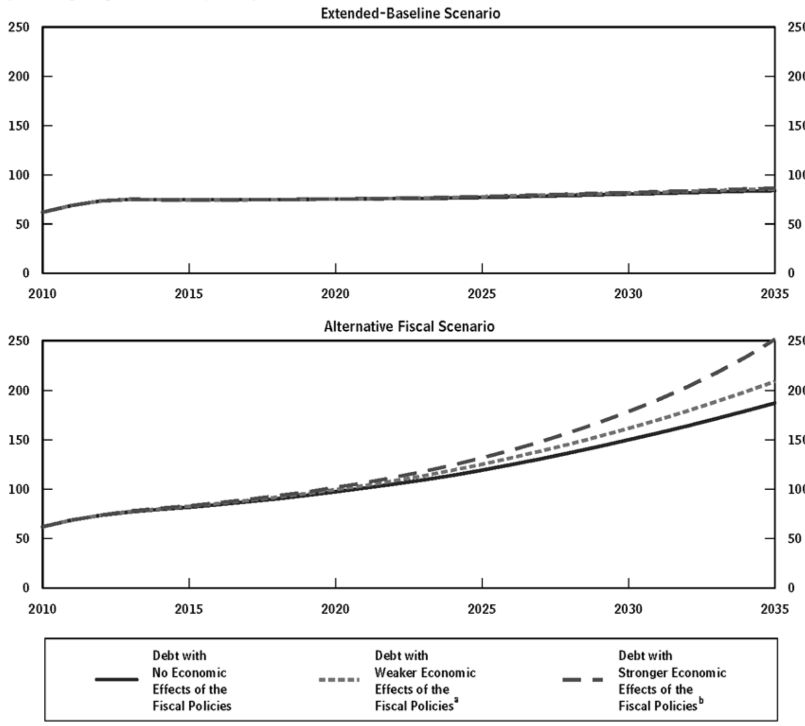
a. The highest estimated value for GNP per person in each year.

b. The lowest estimated value for GNP per person in each year.

Figure 2-2.

Federal Debt Held by the Public, With and Without the Economic Effects of the Fiscal Policies Assumed in CBO's Long-Term Budget Scenarios

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

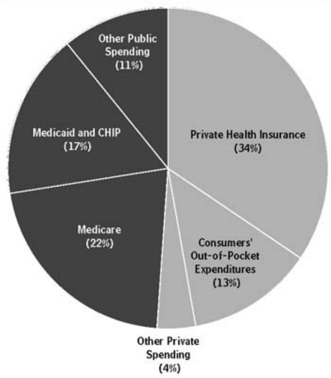
The range of estimates shown stems from varying assumptions about how much deficits "crowd out" investment in capital goods such as factories and computers (because a larger portion of people's savings is being used to purchase government securities) and how much people respond to alterations in after-tax wages and interest rates by changing the number of hours they work and the amount they save.

a. The lowest ratio of debt to GDP for each year.

b. The highest ratio of debt to GDP for each year.

Figure 3-1.

Distribution of Spending for Health Services and Supplies, 2009



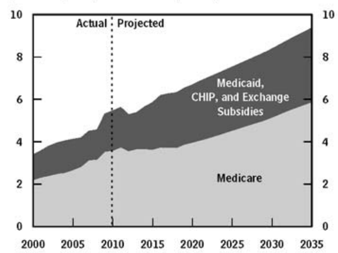
Source: Congressional Budget Office based on data from the Centers for Medicare and Medicaid Services.

Note: CHIP = Children's Health Insurance Program.

Figure 3-2.

Mandatory Federal Spending on Health Care, by Category, Under CBO's Extended-Baseline Scenario

(Percentage of gross domestic product)



Source: Congressional Budget Office.

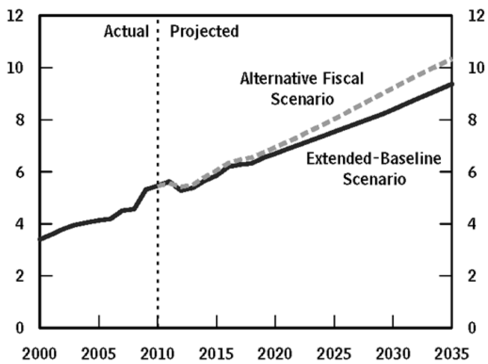
Notes: The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. (For details, see Table 1-1 on page 4.)

CHIP = Children's Health Insurance Program.

Figure 3-3.

Mandatory Federal Spending on Health Care Under CBO's Long-Term Budget Scenarios

(Percentage of gross domestic product)



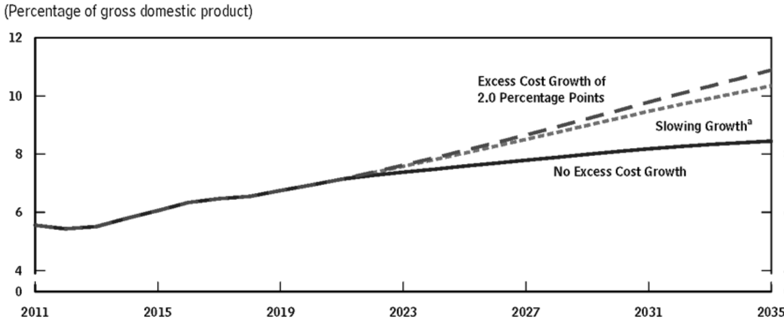
Source: Congressional Budget Office.

Note: The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

Figure 3-4.

Mandatory Federal Spending on Health Care Under CBO's Alternative Fiscal Scenario and Different Assumptions About Excess Cost Growth After 2021

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: Excess cost growth refers to the extent to which the annual growth rate of health care spending per beneficiary—adjusted for demographic characteristics of the relevant populations—is assumed to exceed the annual growth rate of nominal gross domestic product per capita.

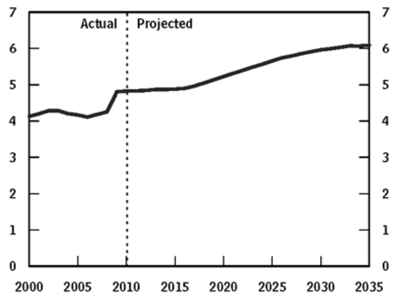
The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

a. In the alternative fiscal scenario, the rate of excess cost growth is assumed to decline each year from an initial value of 1.7 percentage points in 2022.

Figure 4-1.

Spending for Social Security Under CBO's Long-Term Budget Scenarios

(Percentage of gross domestic product)



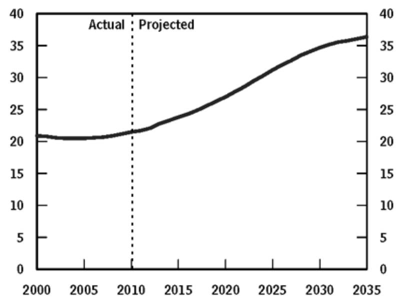
Source: Congressional Budget Office.

Note: Projected spending for Social Security is identical under CBO's two long-term budget scenarios, the extended-baseline scenario and the alternative fiscal scenario. (For details of the scenarios, see Table 1-1 on page 4.)

Figure 4-2.

The Population Age 65 or Older as a Percentage of the Population Ages 20 to 64

(Percent)

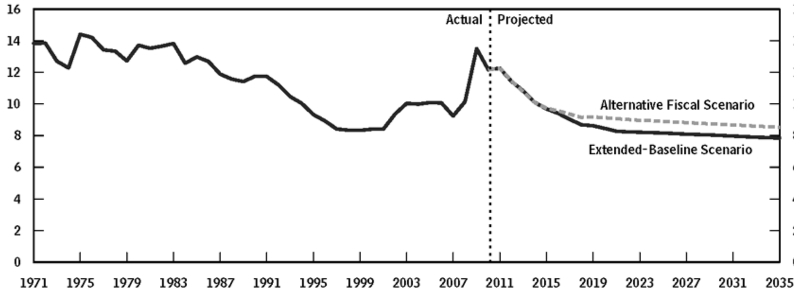


Source: Congressional Budget Office.

Figure 5-1.

Other Federal Spending Under CBO's Long-Term Budget Scenarios

(Percentage of gross domestic product)



Source: Congressional Budget Office.

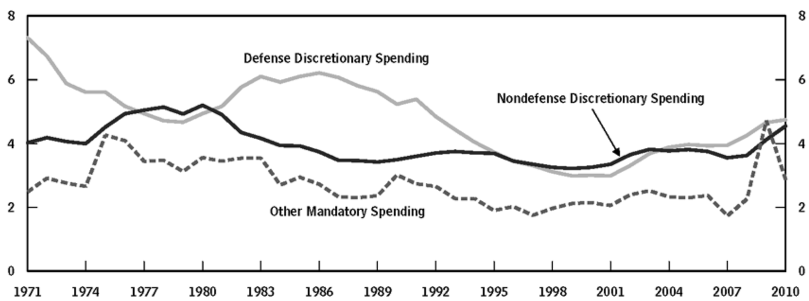
Notes: Other federal spending is all spending other than for the major mandatory health care programs, Social Security, and interest payments on debt held by the public.

The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

Figure 5-2.

Other Federal Spending, by Category, 1971 to 2010

(Percentage of gross domestic product)



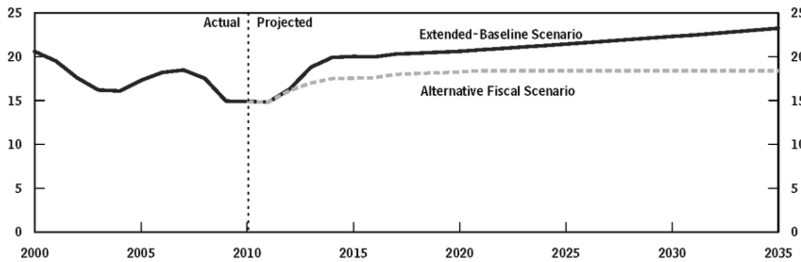
Source: Congressional Budget Office.

Note: Other federal spending is all spending other than for the major mandatory health care programs, Social Security, and interest payments on debt held by the public.

Figure 6-1.

Total Revenues Under CBO's Long-Term Budget Scenarios

(Percentage of gross domestic product)



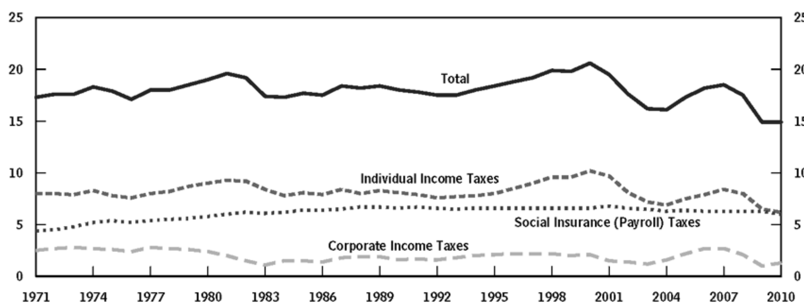
Source: Congressional Budget Office.

Note: The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 6-1.)

Figure 6-2.

Revenues, by Source, 1971 to 2010

(Percentage of gross domestic product)

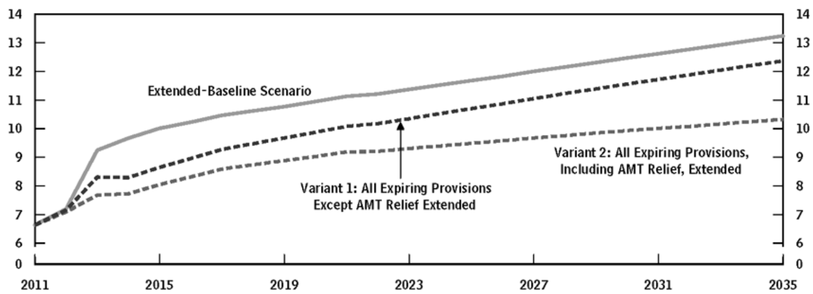


Source: Congressional Budget Office.

Figure 6-3.

Individual Income Tax Revenues Under CBO's Extended-Baseline Scenario and Two Variants

(Percentage of gross domestic product)



Source: Congressional Budget Office.

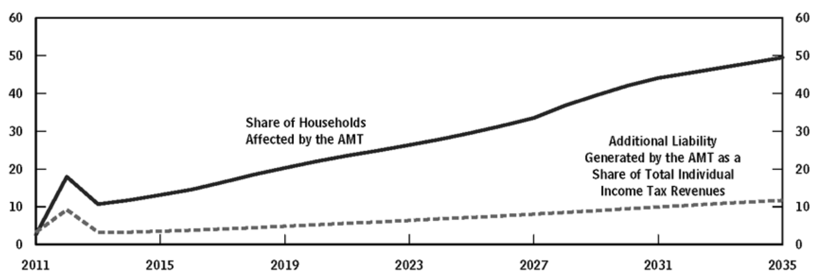
Notes: The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. (For details, see Table 6-1 on page 13.)

AMT = alternative minimum tax.

Figure 6-4.

The Impact of the Alternative Minimum Tax on Individual Income Tax Liability Under CBO's Extended-Baseline Scenario

(By calendar year, in percent)



Source: Congressional Budget Office.

Notes: The shares of households and revenues rise in 2012 after the temporary increase in the AMT exemption expires. After 2012, the shares initially fall because the amount of regular income tax owed rises with the expiration of certain provisions of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Public Law 111-312).

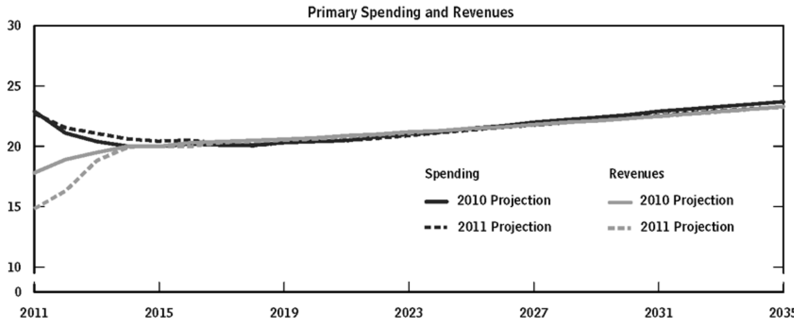
The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. (For details, see Table 6-1 on page 13.)

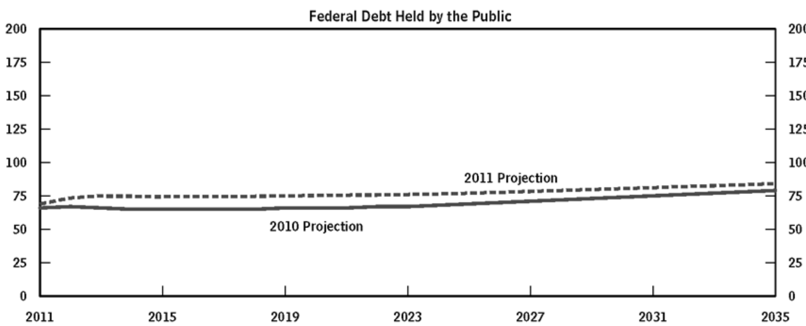
AMT = alternative minimum tax.

Figure A-1.

Comparison of CBO's 2010 and 2011 Budget Projections Under the Extended-Baseline Scenario

(Percentage of gross domestic product)





Source: Congressional Budget Office.

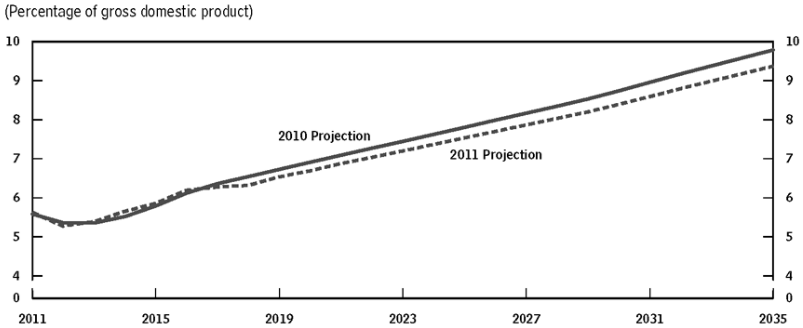
Notes: Primary spending refers to all spending other than interest payments on federal debt.

The extended-baseline scenario adheres closely to current law, following CBO's baseline budget projections for the first 10 years and then extending the baseline concept for the rest of the long-term projection period. (For details, see Table 1-1 on page 4.)

Figure A-2.

Comparison of CBO's 2010 and 2011 Projections of Mandatory Federal Spending on Health Care Under the Extended-Baseline Scenario

(Percentage of gross domestic product)



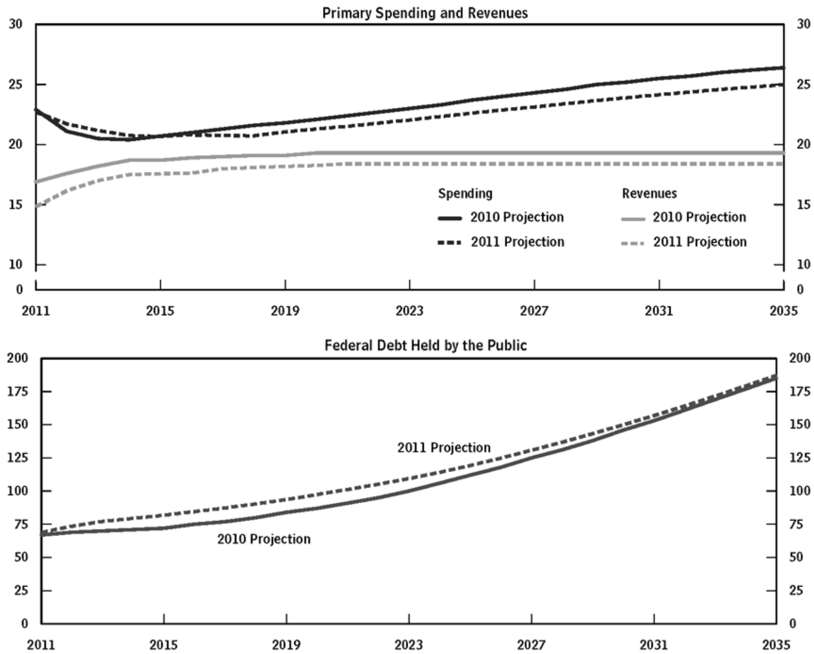
Source: Congressional Budget Office.

Note: The extended-baseline scenario adheres closely to current law, following CBO's baseline budget projections for the first 10 years and then extending the baseline concept for the rest of the long-term projection period. (For details, see Table 1-1 on page 4.)

Figure A-3.

Comparison of CBO's 2010 and 2011 Budget Projections Under the Alternative Fiscal Scenario

(Percentage of gross domestic product)



Source: Congressional Budget Office.

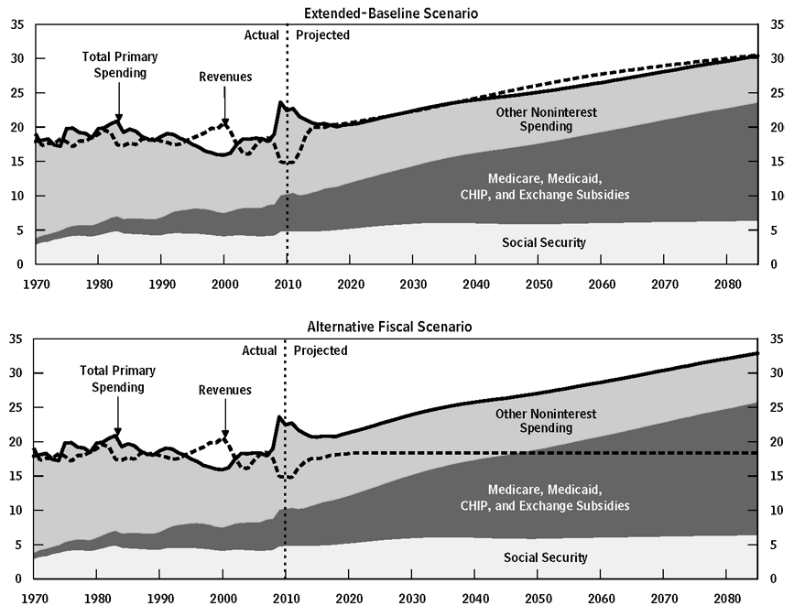
Notes: Primary spending refers to all spending other than interest payments on federal debt.

The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

Figure B-1.

Primary Spending and Revenues, by Category, Under CBO's Long-Term Budget Scenarios Through 2085

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: Primary spending refers to all spending other than interest payments on federal debt.

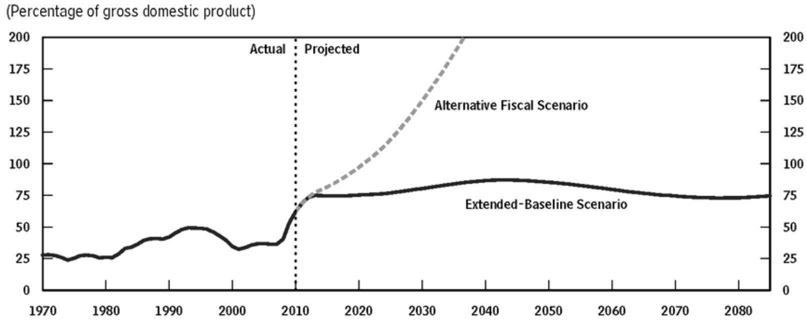
The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

CHIP = Children's Health Insurance Program.

Figure B-2.

Federal Debt Held by the Public Under CBO's Long-Term Budget Scenarios Through 2085

(Percentage of gross domestic product)



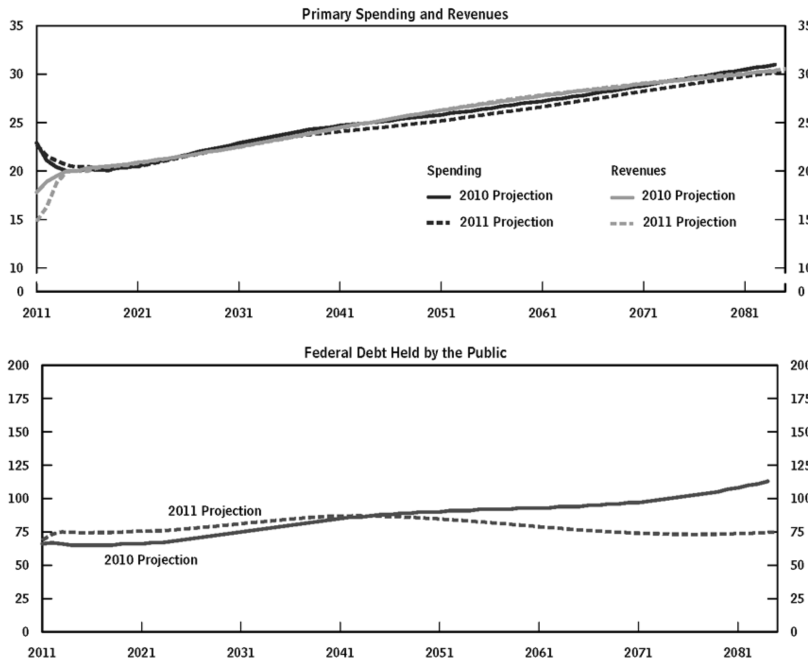
Source: Congressional Budget Office.

Note: The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2021 and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 4.)

Figure B-3.

Comparison of CBO's 2010 and 2011 Budget Projections Under the Extended-Baseline Scenario Through 2085

(Percentage of gross domestic product)



Source: Congressional Budget Office.

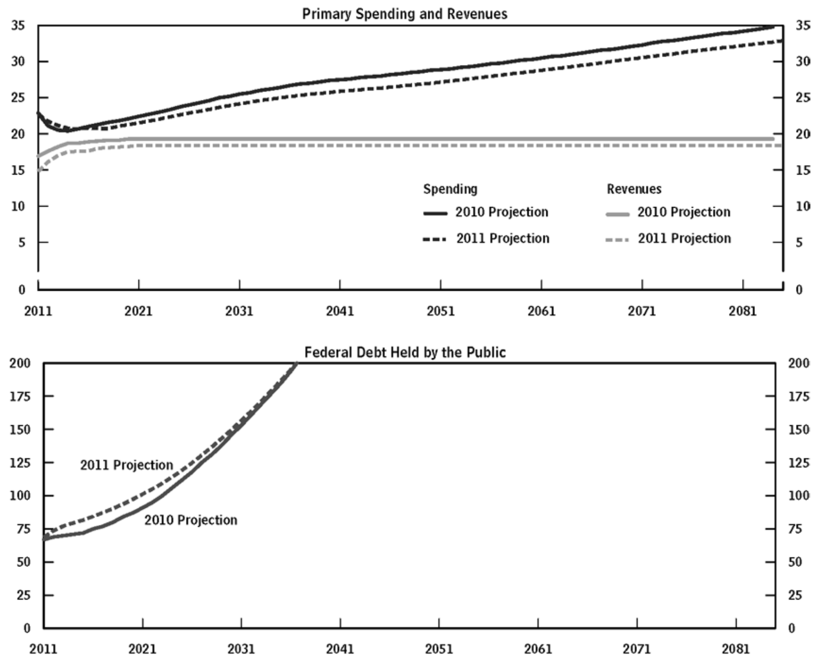
Notes: Primary spending refers to all spending other than interest payments on federal debt.

The extended-baseline scenario adheres closely to current law, following CBO's baseline budget projections for the first 10 years and then extending the baseline concept for the rest of the long-term projection period. In the 2011 projection under this scenario, federal debt held by the public is lower as a percentage of GDP in the later decades of the projection period mainly because of lower projected spending on Medicaid and on insurance subsidies that will be provided through the exchanges created by the March 2010 health care legislation. As discussed in Appendix A, projected spending for Medicaid is lower because of revisions to CBO's 10-year baseline, and projected spending for exchange subsidies grows more slowly because of changes in assumptions about the long-term evolution of eligibility for exchange subsidies and the size of the average subsidy.

Figure B-4.

Comparison of CBO's 2010 and 2011 Budget Projections Under the Alternative Fiscal Scenario Through 2085

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: Primary spending refers to all spending other than interest payments on federal debt.

The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. Reasons that CBO's projections under that scenario changed between 2010 and 2011 are discussed in Appendix A.

Chairman RYAN. Thank you Dr. Elmendorf. I have some questions regarding your analysis of the House Republican budget Medicare Premium Support Plan that I want to get into, and then a little bit about the OMB budget, the president's budget; and then I will let my colleagues get into the actual report here.

In that analysis you show a significant gap between the costs patients would have absorbed under premium support compared to traditional Medicare, Ms. Schwartz went into this a little bit. Your analysis shows traditional Medicare continuing to operate well beyond 2020 when the program's trust fund becomes insolvent. At the same time you report, before today, it says, "Once the hospital insurance trust fund is exhausted the centers for Medicaid and Medicare services will no longer have the legal authority to pay health plans and providers."

In a separate analysis you warned, "A growing level of federal debt would also increase the probability of a sudden fiscal crisis." Yesterday the trustees in Ways and Means confirmed in a hearing that Medicare as we know it ends in 2023, and that is a quote. So I have got three basic questions on this part.

If Medicare's trust funds are empty and paying for Medicare's unfunded promises requires tens of trillions of dollars to be transferred from general revenue, where will these funds come from number one? Number two, how would Medicare be financed amidst a fiscal crisis? And is it plausible that Medicare could continue to provide current benefits indefinitely, as your analysis assumes, in comparing it to our premium support plan?

Mr. ELMENDORF. So on the first question Mr. Chairman, if the trust fund runs out of money then the only way that benefits will be continued at the level specified in current law is if general revenue were used for that purpose, and that revenue can only come from higher taxes or lower spending in other programs.

Chairman RYAN. Or more borrowing?

Mr. ELMENDORF. Or additional borrowing and that leads to the second part of your question, which is what happens in a fiscal crisis if the government becomes unable to borrow at affordable rates, as we have seen some other countries end up in that position. Then there would probably need to be very stark changes in the whole range of government spending programs.

Chairman RYAN. In the immediate term at the time.

Mr. ELMENDORF. Right away, when that situation arises. If the government cannot turn to capital markets to obtain the funds that it needs and it tries to then balance the budget almost literally overnight, then the disruption to the federal government's policies and to the economy and society can be immense.

Chairman RYAN. So this is unsustainable?

Mr. ELMENDORF. The path that the budget is on at our current policies is most definitely unsustainable.

Chairman RYAN. And the Medicare baseline itself?

Mr. ELMENDORF. So, Medicare, the part A of Medicare, funded through the trust fund is on an unsustainable path, and in our own projections the fund is actually exhausted in 2020, a few years earlier than the actuaries.

Chairman RYAN. Okay. So, let's get down to the providers side of this. I have been on Ways and Means, on the Health Subcommittee for a long time, and have gone through a lot of provider issues. Historically Medicare, and both parties have been working on this, Medicare is starting to control costs by paying providers less than private plans?

Mr. ELMENDORF. Yes.

Chairman RYAN. The president's health care law cut providers by $500 billion, not to advance Medicare's solvency but to fund another open-ended entitlement program. On top of that, physicians are set to be cut by an additional 29.4 percent of this January, I believe it is 29.4.

Mr. ELMENDORF. Yes.

Chairman RYAN. Do your projections assume providers will continue to accept Medicare patients at the same rate that they do now under the traditional program? Because let's remember, Medicare already pays providers 80 percent of what they will receive in the private market. By 2030, this will fall to about 40 percent. So do your projections assume providers will continue to accept Medicare patients at the same rate they do now under the traditional program? And does your analysis assume, despite the additional provider cuts coming in current law, that this will have no effect on the quality or access of care?

Mr. ELMENDORF. The way I would put it Mr. Chairman, is that we do not model the behavior of physicians. We do not model the access to care or quality of care.

Chairman RYAN. So you assume it stays on as is?

Mr. ELMENDORF. And that is the point that we noted in the letter analyzing your proposal. That is a gap in our tool kit, and a gap that we are trying to fill. Under the current circumstances we do not model, either in the regular baseline projections or in our analysis of last year's health legislation or your proposal, the effects that might happen under current law or alternatives.

Chairman RYAN. So therein lies the issue here. Your analysis effectively assumes that no matter how much the government pays providers for health care services, providers will continue to deliver the same quality care and access. That is the gap you talk about. While you accept the premise that the imposition of price control has actually reduced costs, strikes me that your analysis does not appear to take into account that choice and competition, despite working nearly every [inaudible] in our economy, and even within Medicare where applied, will put downward pressure on health inflation.

Is the takeaway here the only way to get a grip on skyrocketing health care costs, is through strict price controls and heavy government rationing? Is that what we are to conclude from all of this?

Mr. ELMENDORF. No, I do not think that is a fair interpretation of our analysis Mr. Chairman. As you pointed out yourself, Medicare pays less to providers today than private insurers pay. So it is, I think, an open question as to how much lower payments can go in Medicare relative to private insurers without hindering the access to care or quality of care to Medicare beneficiaries in an important way.

Chairman RYAN. But in your analysis you just do not feel like you have the toolkit to model that? Is that what you are saying?

Mr. ELMENDORF. We do not have the toolkit to model that. We also noted in our letter that we do include the effects of competition in the current private insurance market in accessing the gap today between the cost in Medicare and the cost of treating a similar patient we estimate outside of Medicare. But we do not in the analysis incorporate any effects of competition that might arise over time from the additional price pressures that are built into your proposal and from the additional flexibility that the insurers have relative through traditional Medicare to adjust the way that the insurance [inaudible].

Chairman RYAN. Okay. So to be clear on that point, Medicare Part D which is something we have looked at, has come in at 40 percent below cost projections, now while those savings can be attributed to lower than expected enrollment, CMS calculated that nearly 85 percent of the program savings were, "A direct result of competition and significantly lower Part D plan bids." I mean the premium; I remember we had an amendment in Ways and Means to lock the premiums up at a rate that would be about 25 percent higher than they actually are today. The reforms on our budget are modeled on these kinds of reforms. Seniors choose from a set of guaranteed Medicare approved coverage options.

So when analyzing projected costs under the House passed budget, did you take into account the effect that choice and competition would have on the growth rate of health care cost? And do you assume people will continue to utilize health services at the same rate as they do now? Meaning, what I got out of what you just said, is that you are not really gleaning those kinds of lessons from the experience we have from the Part D results.

Mr. ELMENDORF. So we are not applying any additional effects of competition on this growth rate over time, in our analysis of your proposal; and we do not have again the tools, the analysis that we would need to do a quantitative evaluation of the importance of those factors. I think interpreting the Part D evidence, and interpreting other evidence in the world is complicated.

At the time of the Part D estimate, that we made which was above the ultimate cost, prescription drugs spending throughout our health care system was rising very rapidly. We expected it to slow. It slowed much more abruptly throughout the health care system than we had anticipated at the time. Part D shared in that slowdown. That is, again, a health care system wide phenomenon. The extent to which that was passed through to Medicare Part D, in a way that it is different that it would have been under an alternative structure for Part D, is a more subtle analytic question. And if one looks at other examples where one tries to compare more traditional health care programs to systems where there is competition among private insurers, the comparisons are not so straight forward. There are, as we show on our report, there are periods of history when costs in the public programs are growing faster than costs in the private insurance, and there are periods where the opposite can be seen.

If one looks at the FEHBs, the Federal Employees Health Benefit Program, premiums in that program have risen fairly rapidly along with premiums in the rest of the health care system, roughly, despite the competition that occurs there.

But interpreting this evidence is tricky. We have a public health care programs that have evolved over time with a lot of policy changes. It is not a clean run of a certain set of policies. We have a private health care system that has been affected by developments in the public health care system, that is affected by the tax treatment of employer sponsored health insurance. So it is not a clean run of a purely private system either. So what we are trying to do, but this is a long project for us, is to glean the lessons from these different parts of our historical experience to try to address the central policy issue you raise, which is the power of a public's defined benefit health care system versus a system where the government makes defined contribution the competing private insurers try to give you some more analytic reporting.

Chairman RYAN. And that is what I want to encourage to you. Look you guys, and Joyce's whole shop over there does such great work, but if we stick with the analytical tool we have, or the lack of tools we have, then the only conclusion is price controls. And I think economic evidence throughout history shows us what happens there. So, I think we have got some work to do to really analyze this; any plan, put ours aside for the moment, any plan who addresses fiscal crisis obviously must address health care programs.

Mr. ELMENDORF. Yes.

Chairman RYAN. And health inflation, and measuring any of these plans against what is really a fiscal fantasy, which you are acknowledging, an unsustainable trajectory is really not an accurate measurement or comparison, because it is comparing some plan against a future which we now know cannot continue.

And so, I think we all have to do more work to try and figure out how to really truly address these issues. I will leave it at that because I wanted to get into the budget only to say we got your reanalysis of the president's budget. I will not go back into that, but the president gave a speech on April 13, where he outlined a new budget framework that claims $4 trillion in deficit reduction over 12 years. Have you estimated the budget impact of this framework?

Mr. ELMENDORF. No, Mr. Chairman. We do not estimate speeches; we need much more specificity than was provided in that speech for us to do our analysis.

Chairman RYAN. All right. I will leave it at that. Ms. Schwartz.

Ms. SCHWARTZ. Thank you. Let me also take a slightly different approach, obviously, on Medicare. One is that we are concerned about this long-term fiscal health of Medicare, it is one of the reasons we passed a law last year in order to use every idea that exists out there for containing costs, and insuring quality and access for seniors. You have looked at some of this and have acknowledged that while it may be difficult to quantify all of the cost savings that exist, you acknowledge that there are cost savings. I think both you and the Medicare trustees have talked about that at a minimum it is going to save money over the long run, what we did in the Affordable Care Act; and it does extend the fiscal health of the trust fund for a number of years. It could do even better than that if much of the work that is being done in payment and delivery system reform to reduce unnecessary tests and duplication and waste as well as to coordinate care and improve, again, the efficiencies in the health care system. It is not just about future service reimbursements. It is actually changing the way we do this so the debate does not become, simply, how much do we reimburse doctors, particularly relative to the private sector. So, can you just say yes or no that that is true?

Mr. ELMENDORF. Yes, there were important changes made in the structure of Medicare's payments to providers, a whole collection of changes and experiments in last year's legislation. I would note that some people were frustrated at our analysis of that, quite comparably to the Chairman's frustration at our analysis of this year's proposal from him, that we do not have the tools, perhaps, to capture the full effects of certain changes and we are working in that area as well to build a stronger toolkit to provide you with better information.

Ms. SCHWARTZ. But I do appreciate as some of these regulations come out that CBO has been able to respond and say this is what we believe, whether it is ACOs can save hundreds of billions, or some of the other actions we are taking in patients and medical homes or pay for performance for hospitals, that actually has a cost savings that you have been able to analyze.

Mr. ELMENDORF. Yes, so we certainly have estimated some savings and, again, I think that for some of the more unusual experiments, we are struggling ourselves with developing tools that could enable us to provide even better analysis of them.

Ms. SCHWARTZ. That is right. I just want to make it very clear of course, that what we did in the Affordable Care Act was to set out a path, and this is a path, it is not going to happen in 10 minutes; it is a path for us to be on to get better value for our dollars and to assure access to the highest quality care for our seniors and the benefits they might have.

I do want to focus on the other piece of what we are talking about in Medicare, in particularly the Republican proposal for as they call it a "premium support voucher." Well they do not call it voucher, it's "premium support," which is basically the same thing.

Chairman RYAN. Would you like to yield on that? I am happy to go into this if you want to.

Ms. SCHWARTZ. No, it is fine. No I completely understand how you would equate it to the federal employees and to the Congress.

Chairman RYAN. There is a difference between "premium support" and vouchers and CBO is very clear about that.

Ms. SCHWARTZ. I am sure he will answer then. Let me ask the question; one of the things that seems clear, and I think is understood, and I wanted you to clarify this, is that if we are going to give seniors a certain amount of money, a capped amount in order for them to be able to go and buy private insurance in the marketplace, as costs rise who pays for the additional costs? You have been very clear about this, both initially and over time, so could you just answer that question?

Mr. ELMENDORF. In a defined contribution system where the government's contributions are set as under Chairman Ryan's proposal, then whatever extra amount private citizens need to pay to obtain the services, they would pay themselves.

Ms. SCHWARTZ. Right. Have you estimated about how much that would be for the average senior?

Mr. ELMENDORF. What we have showed in our letter analyzing the plan was the effects for a typical 65-year-old buying a standardized health insurance benefit, and we estimated that in 2022 for example, under the baseline scenario a 65-year-old would pay 27 percent of the cost of this standardized benefit. Under the proposals seniors would pay 61 percent of the cost of that benefit.

Ms. SCHWARTZ. Can you give a number about what that is? I have read that it is about $6,000 that the average senior, a 65-year-old would expect to pay and it could go up as much as $12,000 over time.

Mr. ELMENDORF. So I do not have a dollar figure and I am told by my colleague that we did not provide a dollar figure.

Ms. SCHWARTZ. The point I am making here of course is that the Republican proposal that is been voted on and supported by just about every Republican in the House, does shift the burden of additional costs to the seniors, to individual seniors.

Mr. ELMENDORF. Yes, by our estimates it shifts a good deal of additional burden and also shifts risk regarding the ultimate costs.

Ms. SCHWARTZ. Right. So the notion that seniors will be able to get the same benefits, and would be able to buy it all depends on whether they have an extra $6,000 or $12,000 a year to pay for them? Or whatever it might cost. It is their choice. And I understand Republicans see it as this choice, we see it as if you cannot afford it, it is not much of a choice.

Mr. ELMENDORF. So their ability to buy that package of benefits depends on the resources they have available and, of course, on our estimates being correct as well about those costs.

Ms. SCHWARTZ. That is right. The other point I want to make and I think you have made this as well, is that if we are all concerned, and we are, and I think you just had this dialogue with Mr. Ryan about how we contain the rising growth in costs. Is it a responsibility that they can be shared by public programs and private insurers, it is one of the paths we are trying to move on health reform: How do we actually get better value, and contain the rising costs. Businesses in my district, nationally, and individual families have seen a 100 percent increase in premiums; and it is double digit increases every year over the decade, it is been double what you pay for health premiums. Under the Ryan proposal, the Republican proposal, they are no cost containment built in except for the individual senior not being able to afford to buy the insurance. But there is not anything that actually moves the system to improve quality, reduce costs over time, and eliminate wastes. Is that correct? Can you speak to that about the costs, and containment piece the lies in the private sector to do it through what people can afford to buy?

Mr. ELMENDORF. So let me make two observations. The first is that as I understand the Chairman's proposal, traditional Medicare would continue roughly along the lines in current law, and because people only move into this new system, as they turn 65 under this proposal, a good deal of the patients in Medicare, and an even larger share of the spending in Medicare remains in the traditional Medicare system, for decades to come.

Ms. SCHWARTZ. Yes, well, if they move 65-year-olds would be in a very different system, they would not be in, if you want to call it traditional Medicare, anymore after a certain point. It would go side by side for a while.

Mr. ELMENDORF. I am just saying that for the next 20 years, by 2030 even, more than half of Medicare beneficiaries are still receiving traditional Medicare; 45 percent are receiving the premium support payments, so it is a gradual transition and the programs, and again as I understand the proposal, the programs in place in traditional Medicare would remain. The second observation is that the proposal, rather than directing specific sorts of experiments on changes as was done in last year's health legislation, would rely on the price pressure affecting competing private insurers to rely on them for those steps instead.

Ms. SCHWARTZ. But does that mean then that all the cost containment provisions that are built in to the law that we have now, if it should be repealed, will then go by the wayside, and we will not see those cost containments. You call them experiments, but a lot of work has been done in the health care system and I apologize this is not your expertise, you said you have not drilled down in all this, there is a lot of important and good work that is being done across the country that is actually getting better value for the dollars. We are trying to scale that up for more seniors.

Mr. ELMENDORF. Yes. So I do not mean to belittle this in any way by using the word experiment. What I am trying to signal is that the successful experiments at getting greater value, and there have been a number of them, have tended to be fairly localized; and the question of how they can best be extended across the country is something that both Medicare and private insurers are wrestling with.

Ms. SCHWARTZ. That is right an all payer system would be great.

Mr. ELMENDORF. Both Medicare and private insurers are trying to find different ways of being providers and so on. So I do not mean to belittle that but just to say that there will be a certain amount of trial and error, again for both public and private insurers. Whatever the system is of insurance we need our health care system to become more efficient and I think the crucial policy question is whether a more public or a more private system applies more of the useful kinds of pressure and avoids more of the detrimental kinds of pressure as you would judge that?

Ms. SCHWARTZ. Well, as I believe my time is up but I think this is a conversation that we have tried to advance that we will contain the rising growth and cost in Medicare. Because we are serious about that as well, that this needs to be done in order to sustain a Medicare as we hope to, but turning over to a private sector, it has not been very good at containing costs either for businesses or for families, or for seniors for sure, that that actually is a model we cannot rely on. The fact that the federal government pays about 46 percent of the costs of health care in this country if you look at all the different programs. We could and should be, in our view, a force for improving quality and insuring access. I think that is one of the big debates that we are having of course.

Chairman RYAN. It is, I am going to take my Chairman's prerogative and join this, not get in a tit-for-tat, but I want to just try and help answer the questions you asked the director. To show you what is kind of our thinking and why we propose what we propose, because you are right, we got to figure this out on Medicare. Medicare is the biggest driver of the debt in the future, and the Affordable Care Act does attempt to do that. We disagree with the way in which it attempts to do that. Now when you say there is not cost containment, there are two ways of doing this; do you put the patient in charge or do you put the bureaucracy in charge? We think a patient centered system is a better way to go. Now when you put the bureaucracy in charge, let's take a look at where we are headed right now.

Accountable care organizations, the idea in theory is a very good idea, but look at what is happening. CMS is putting this rule out there; nobody is going to participate in it. So let's have a system that is decentralized and not government centralized. Let's not go with price controls because price controls it might make the numbers add up on paper but it will just deny access to people. And so, what we have found is that when we continue to underpay providers which the trustees are telling us, providers are going to get about 66 cents on the dollar from Medicare now, going down to 33 cents on the dollar, we cannot assume that they are going to keep taking Medicare. And so, I or we, do not think that that is the proper approach. More to the point, we do not think unelected unaccountable bureaucrats, technocrats, no matter how smart they are can figure out how to micromanage 17 percent of our economy. We believe that providers competing against each other, insurance companies, hospital, physicians, competing against each other for our business, as empowered consumers is a better way to go, and we have a lot of evidence that shows that.

Now two, the point that his analysis does not include, it does not include the fact that we have proposed to risk adjust subsidies. As a person gets sicker in Medicare, we want them to have a higher subsidy to protect them against ticker shock. It also does not include the fact that we have proposed to add an additional $7,800 to begin with, which keeps growing every year, to low income seniors, to subsidize and cover their out-of-pocket costs. There is only so much money to go around, and our point is we should not subsidize wealthy people, as much as everybody else; and we should subsidize low income people even more than everybody else. That is the way we think tax payer dollars ought to be deployed, and we want the patient to be the nucleus of the health care system, in Medicare and everywhere else, instead of some board of 15 technocrats giving Caesar's thumbs up or thumbs down on whether this will work or not; or who gets paid, what, where, when, and how much. We do not think that will work because we have lots of evidence already that it does not. With that I yield.

Mr. ELMENDORF. Mr. Chairman, so you are certainly correct in saying that in numbers that I have quoted, and are featured in our report, did not include the effects of the additional support for lower income people as we noted in our letter.

Chairman RYAN. Correct.

Mr. ELMENDORF. I do not understand though your point about risk adjustment. What we reported was the cost for a typical 65-year-old, we understand and included in our model.

Chairman RYAN. Right. The illustration does not suggest that a sicker person will get higher income. You are doing an average; it is an average so it does not take into consideration the fact that a person who has higher core morbidities, higher risks, get a higher subsidy.

Mr. ELMENDORF. To cover the higher cost, so they end up getting health insurance coverage.

Chairman RYAN. Right. I can take up more time on that but our analysis now. Mr. Flores.

Mr. FLORES. Thank you Mr. Chairman. Dr. Elmendorf, thank you for being here today; your introductory comment I thought pretty well said it all. And that is that the budget outlook is daunting. I agree with you; it is unfortunate we have been left in this situation from the last four years of a Congress that was controlled by the other side that racked up $6 trillion in debt. I want to talk about three things and Figure 2.1 of the materials that you handed out today; you have some GDP growth charts. Can you tell me quickly what the GDP growth assumptions were in the extended baseline scenario and in the alternative fiscal scenario?

Mr. ELMENDORF. Well, so Congressman, we set for the underlying path, the benchmark to use for the most of the budget projections, a stable economic future. Then we analyzed, as you have seen, the effects.

Mr. FLORES. Just give me some numbers real quick.

Mr. ELMENDORF. So under the alternative fiscal scenario, GNP would be 7 to 18 percent lower in 2035, than it would be under our benchmark that assumes steady debt to GDP ratio.

Mr. FLORES. And what is steady? I mean, not debt to GDP, but what do you look at in terms of real GDP growth percentage per year, long term?

Mr. ELMENDORF. So the real GDP growth that we have is 2.2 percent on average per year, from 2022 to 2085.

Mr. FLORES. And that is lower than what we have experienced historically, long term I believe, is it not?

Mr. ELMENDORF. It is lower articulately because of slower growth of the labor force. It is related to the population aging that we see.

Mr. FLORES. Let's talk about tax payer behavior. Now that is my second subject. If, you talked about the fact that taxes would rise to 23 percent of GDP under the extended baseline scenario I believe, is that correct? What you said, do you model tax payer behavior in a situation like this? In other words, do you live in Maryland, or Virginia, or D.C.?

Mr. ELMENDORF. I live in Maryland.

Mr. FLORES. Okay, so if Maryland doubled its tax rates tomorrow, would you move?

Mr. ELMENDORF. My kids just finished their sophomore year in high school Congressman. If I move I am in peril of my life.

Mr. FLORES. Okay, you would be looking at it though right?

Mr. ELMENDORF. But our analysis does incorporate the effects of changes in marginal tax rates. That is an important area that we have actually enhanced our analysis of in the past few years, and that, the differences in marginal tax rates as well as the differences in debt are included in the GDP.

Mr. FLORES. And that factors in to the lower than average GDP growth? So there is an impact on revenue by raising these rates because you have put a break on the economy as you move forward?

Mr. ELMENDORF. Yes, under the extended baseline scenario. I read you the numbers for the alternative scenario where there is more or less steady marginal tax rates and rising debt.

Mr. FLORES. Where I am trying to go, and I think you have concurred with this is to the extent that you have assumed that tax revenues is percentage of GDP are higher than the 18.3 percent long-term average. It has a dampening impact on economic growth, correct?

Mr. ELMENDORF. So one thing I would emphasize is the marginal tax rates as you have said before that really matter for economic growth not just the level of revenues, it is how that money is raised so our modeling captures the effects of the marginal tax rates the disincentive to work or to save.

Mr. FLORES. Right, good, okay. The next question has to do with provider behavior. I mean again, everything that happens in the economy is because an individual or a company behaves in a certain way based on the conditions that are thrown at it by its government or by some other exogenous factor. When you look at provider behavior, if we were to cut the pay of everybody in CBO by two-thirds, would that impact the behavior of people wanting to work for CBO or move to your position?

Mr. ELMENDORF. I am afraid it would Congressman, yes.

Mr. FLORES. Okay, so essentially what the chainsaw that was applied to provider reimbursements under the Obama Care if you will, does impact provider behavior; and your modeling does not assume any change in that behavior, right?

Mr. ELMENDORF. That is right. We do not capture, again this is an issue we are trying improve, but our modeling does not capture in any sophisticated way the possible ramifications of that.

Mr. FLORES. So looking not theoretically but a likely realistic outcome is, if we cut what the reimbursement rates are to providers by two-thirds, we are going to have a lot fewer providers hence less health care.

Mr. ELMENDORF. That is a possibility Congressman, but I do not think it is at all guaranteed. There are a lot of experts in the health care system who say there is an awful lot of inefficiency, in the way things currently are being managed, and that by changing the organization of the health care system, that a lot of efficiencies can be achieved, and thus that providers can continue to cover these lower, more efficient level of costs with lower payments.

Mr. FLORES. But you just said it would not work at the CBO, if I cut your pay by two-thirds.

Mr. ELMENDORF. So I think the issue there is what the possibilities are for improving the efficiency of the system. And we have said ourselves, in our analysis of the health reform legislation last year, that how long those cuts could be sustained for was uncertain. And that is why we present an alternative scenario here, in which those cuts are not sustained for a very long period, but I do not think it is at all obvious that those cuts cannot happen for some period of time. We do not know how far they can go, partly because we do not know what the possibilities really are for improving efficiency in the health care system, not just as a theoretical matter but practically speaking what kinds of efficiencies can be achieved not in particular places but across the system as a whole.

Mr. FLORES. Could the CBO operate with two-thirds fewer people? Would you be able to stream out enough efficiencies to provide the same product you do today?

Mr. ELMENDORF. No, we could not Congressman.

Mr. FLORES. Okay well, I suggest that the same is true for any health care system, and that is a very important part of the U.S. economy. Thank you. Yield back my time.

Mr. DOGGETT. Thank you very much. I think one word around which this Congress is focused so far this year is cuts; immediate, far-reaching cuts. The Education Committee has met and voted to eliminate dozens of education programs. Another Republican group has said Pell grants which allow folks to go to college are just another form of welfare and that we cannot sustain the level of financial assistance we have. Votes have been taken to eliminate federal support for community policing and fire fighters. And of course, it is seldom a week that goes by that there is not some proposal to cut health care. Putting aside for a moment, the far reaching consequences of denying educational opportunity, and health care, and adequate law enforcement, I want to direct your attention to the comments of the Chair of the Federal Reserve yesterday, Dr. Bernanke, who said, “In light of the weakness of the recovery, it would be best not to have sudden and sharp fiscal consolidation in the near term. I do not think that sharp, immediate cuts in the deficit would create more jobs.” Do you agree with Dr. Bernanke?

Mr. ELMENDORF. Yes I do Congressman, and we have said the same thing ourselves on a number of occasions.

Mr. DOGGETT. I thought that was the case. So while we want more efficiency, and we want to address these long-term costs, if these cuts are too dramatic they not only will deny educational opportunity and health care security but they will cause us to lose more jobs and have less economic growth?

Mr. ELMENDORF. Again, the specifics would depend on the specific policies, but our analysis implies that cuts in government spending or increases in taxes during the next few years would by themselves reduce output in employment relative to what would otherwise happen. At the same time credible reductions in future deficits would boost output in employment in the next few years because they would hold down interest rates, and probably increase business and household confidence.

Mr. DOGGETT. And I certainly agree with you on both points. On the long term, I guess the only problem is the specifics. So let me go to one of those specifics and I want to try to quote back exactly what you said to Ms. Schwartz, that I believe plans similar to what Chairman Ryan has advanced with reference to Medicare will “shift a good deal of burden and risk to seniors.” Now it is great to talk in theory about putting the patient in charge. We have had the patient in charge with regard to seniors on Medicare in the past with prescriptions, and I guess we can put them in charge again and that may reduce consumption of health care because there will be some seniors that will say I rather eat than go see the doctor, or buy another prescription. I am going to keep cutting my pills in half. That is the patient as nucleus. While you may reduce some consumption that way, in Medicare; what I hear you saying is that we have an overall problem about rising health care costs that affects at different amounts at different times both the Federal Employee Plan, Medicare, Medicaid, the Veterans Administration, and the private sector; and that if all we do is shift more of the burden, a good deal of the burden, and more of the risk to seniors and we have not found a way whether it is through experiments or something else to address the problem of rising health care costs, we may have relieved some of the burden on our debt and on our tax payers but we have not relieved the burden indeed we have increased it on some of the most vulnerable people in our society at the time that they are trying to achieve a decent level of retirement security. Would you agree with that?

Mr. ELMENDORF. Well, Congressman, certainly if the Congress chooses to shift the burden to all or some members of an age group or other demographic group, then that is addressing the government’s budget constraint by tightening other people’s but I would just emphasize that almost anywhere I can think of to address the government's budget constraint involves tightening somebody's budget constraint. That, as I said, we are collecting, we are used to collecting, a certain amount of revenue relative to GDP, which has varied over time but has not shown much trend around this 18 percent mark; the same time we have government programs that provide certain sorts of benefits to older Americans, Social Security, Medicare, and Medicaid, and we have a whole lot of other tasks for the government, National Defense, Homeland Security, Veteran's Care, and on and on, that have over time occupied a certain share of GDP. We cannot have all those same things together in the future. We cannot repeat the past in the federal budget because of the aging of the population and rising health care costs.

Mr. DOGGETT. Certainly we cannot; but we can avoid, as you say, shifting a good deal of the burden and risk to seniors without addressing the broader issue of health care costs. Thank you very much.

Chairman RYAN. Mr. Huelskamp.

Mr. HUELSKAMP. Thank you Mr. Chairman. Doctor, thank you for joining us here today. Quick question, how many years have you been director at the CBO?

Mr. ELMENDORF. Almost two and a half years Congressman.

Mr. HUELSKAMP. Two and a half years, and director, we have had discussions today of the House Republican budget plan and I am a freshman; how long has it been since you have actually analyzed a Congressional Democrat budget plan?

Mr. ELMENDORF. Well, so Congressman, I do not want to sound too technical but we do not really analyze budget resolutions usually. Budget resolutions come from the Budget Committees, in fact for Chairman Ryan's proposal we analyzed the longer term impact of that proposal, as we have analyzed the longer term impact of other proposals he has had. We do not really do an estimate of a budget resolution, it is not a bill, it is not a law.

Mr. HUELSKAMP. So, the Senate Democrat Proposal, out of their Budget Committee, when was the last one you analyzed that came out of their committee?

Mr. ELMENDORF. I think Congressman, that the last budget resolution voted on by the Senate Budget Committee was in 2009.

Mr. HUELSKAMP. 2009, been a little over two years? Or did they even have one in two years?

Mr. ELMENDORF. So I believe they did in 2009 because the reconciliation instructions that came out of that budget resolution turned out to be quite important in the final act of the health legislation.

Mr. HUELSKAMP. Did that pass the Senate?

Mr. ELMENDORF. Yes, I believe, I guess I am not sure Congressman.

Mr. HUELSKAMP. And then the House Budget Committee, that time, did they pass a budget proposal?

Dr. ELMENDORF. I guess we are not completely sure Congressman. Again, it is a piece that we do not look at directly.

Mr. HUELSKAMP. I was trying to figure that out. I have heard that there has not been anything passed for a couple years, and that is pretty amazing to me. What I want to talk about though is a question on your economic assumptions. You talk about pages

26 through 28, the impact of more borrowing, higher tax rates, and its impact on economic growth; and economists pretty well agree that if you increase spending by issuing more debt it is going to impact the private economy negatively, increasing spending by raising taxes will do the same. So under most economic assumptions it would seem that the only reasonable alternative is still grow the economy and tackle the deficit is actually reducing spending now? Is that correct?

Mr. ELMENDORF. Well, Congressman, there are tradeoffs here, so higher marginal tax rates do reduce economic activity to some extent under the views of most economists. But certain forms of government spending are important for economic growth, and reducing those could be damaging to economic growth.

Mr. HUELSKAMP. Excuse me, doctor, but in your analysis, this is pages 26 to 28 talked about increasing taxes will hurt economic growth.

Mr. ELMENDORF. Marginal tax rates.

Mr. HUELSKAMP. Yes.

Mr. ELMENDORF. Yes.

Mr. HUELSKAMP. As it is been suggested by the president. Additionally, by borrowing more debt it has a similar impact on the economy.

Mr. ELMENDORF. Yes.

Mr. HUELSKAMP. And so, explain to me that while reducing spending is not the only alternative.

Mr. ELMENDORF. So again, Congressman, for a dollar reduction in the deficit if one cuts some form of spending that was not itself an investment in economic growth, that would be better for the economy than if one raised a dollar through an increase in marginal tax rates.

Mr. HUELSKAMP. So is Medicare spending an economic growth driver?

Mr. ELMENDORF. I do not think it is an important driver in the long term.

Mr. HUELSKAMP. How about Social Security?

Mr. ELMENDORF. I do not think it is an important driver in the long term.

Mr. HUELSKAMP. How about the Department of Defense budget?

Mr. ELMENDORF. Again, there are some pieces of it that have mattered.

Mr. HUELSKAMP. We have just eliminated two-thirds, or three-fourths of the budget, doctor, is economic growth drivers on the spending side? We have to be spending. You just eliminate two-thirds of it, so the remaining third drives economic growth?

Mr. ELMENDORF. Just saying Congressman, that there are pieces of federal spending that have been important in economic growth. I do not have an exhaustive list of that, and we are not good at modeling those effects.

Mr. HUELSKAMP. But you do make a statement that, and you did not identify that in the report, I would appreciate a follow-up if you could identify the particular programs that you believe drive economic growth. Mr. Bernanke refuses to identify those. Refuses to face the possibility that we have a debt crisis, and that if we do not face that very soon and quickly, and suggest that we cannot cut spending, that somehow we can borrow on tax and that is going to work out. Obviously your report does not say that, so I would ask that as a follow up if you could provide that determination if you would, of the type of spending CBO believes will help drive economic growth, because we are working with that now. And I would appreciate that distinction.

Mr. ELMENDORF. I will be happy to work with your staff Congressman and provide the information you are interested in.

Mr. HUELSKAMP. Thank you Mr. Chairman. Yield back my time.

Chairman RYAN. Mr. Yarmuth.

Mr. YARMUTH. Thank you Mr. Chairman. Dr. Elmendorf, nice to see you again; thank you for your testimony and your work. Earlier Mr. Flores mentioned in passing $6 trillion worth of additional debt over the last four years attributed to Congressional activity, have you done an analysis of the factors that contributed to additional $6 trillion in debt? How much would have been attributable to Congress' actions and how much to policies that were already in place?

Mr. ELMENDORF. So Congressman, we have done analyses sometimes of the swing in the budget deficit from what CBO is projecting about a decade ago to what has come to pass and as it turns out I think I have that table with me. I often do not remember to bring it but I have it with me; and as you I think know Congressman there have been a collection of policy actions taken over the last decade that have significantly worsened the current budget picture. There has also been a collection of developments in the economy that were not predicted by CBO that have also led to worsening of the budget situation.

Mr. YARMUTH. Okay. Would you say that a majority of the additional accumulated debt over the last four years was because of Congressional activity or because of existing policies; Bush tax cuts, and wars initiated in the earlier years?

Mr. ELMENDORF. So relative to our baseline projections in January 2001, so a little over 10 years ago, the deterioration in budget outcomes in 2008, '09, '10, and '11; those are what [inaudible] use as the four years, are due much more to legislative changes than to the economic and technical surprises. And those legislative changes include both reductions in tax revenue and increases in spending.

Mr. YARMUTH. Yeah. Okay, we will leave it there. There is been a fair amount of conversation already about the impact of increase in marginal tax rates. When you make those statements, conclusions that they reduce economic activity, do you assume an increase in marginal tax rates across the entire population? Do you break it down as to the impact on economic activity of raising the marginal tax rates on people making over $250,000, and then people making over $1 million? And is there a difference in the impact, economic impact of those increases?

Mr. ELMENDORF. So, Congressman, we do look at the effects on a variety of income categories. I do not know exactly what they are off-hand. And we try to apply historical evidence about what we think the responsiveness would be, and you can see some of this analysis testimony we did for the Senate Budget Committee last fall that different ways of extending the expiring tax provision, and some of those scenarios we studied we assumed that all of the expiring provisions were extended. That did in fact occur in the end of last year, in other scenarios we looked at extending only the tax provisions up to a certain point in income distribution and not a above that. I do not have those results at hand.

Mr. YARMUTH. Is it safe to say as a general proposition, that if you raise the marginal tax rate from 35 percent to 39.6 percent on people making over a $1 million a year, that that will not have a huge drag on the economy versus extending the marginal rates on the other 99 percent of the population.

Mr. ELMENDORF. Well, there a question about the total impact and the impact per dollar of revenue. So there are many more people on the rest of the distribution. Much more income earned, and thus changes in the marginal tax rates below that threshold will have a larger aggregate effect on the economy. But per dollar revenue lost, the effects are generally larger at the top of the income distribution because the changes in marginal tax rates, the lesser revenue is given up in a sense relative to the change in the incentives. So in terms of the distortion to the economy per dollar revenue lost that is not smaller at the top than it is at the bottom. But it depends on the precise nature of the tax policies.

Mr. YARMUTH. Okay, I look forward to discussing that further. One last question, in the Republican budget that was passed by the House there is an assumption, as I recall, that unemployment drops to 2.8 percent by 2015 in that range and then stays at a, relative to today's terms and historic terms, a very low level. I believe I am correct on that. If I am not I am sure the Chairman will.

Chairman RYAN. I will, correct you.

Mr. YARMUTH. But what kind of assumption do you make in your baseline scenario as to what unemployment would be for the next 10 years or so?

Mr. ELMENDORF. So because the recovery is slow, we think the unemployment rate will come down, only slowly and will over the second half of the coming decade be down to about 5¼ percent of the labor force.

Mr. YARMUTH. Okay, thank you.

Chairman RYAN. I will just answer the question, that is not an assumption in the budget. CBO is the measuring stick we use. There was an outside economic forecasting group that did its own separate analysis of the budget, they subsequently revised that analysis to a deal with that particular statistic which they said was an anomaly and wrong; and they revised it to I think five percent or something like that. Next is, Mr. Stutzman.

Mr. STUTZMAN. Thank you Mr. Chairman and thank you Mr. Elmendorf for being here. My question is, in your report you note the federal government could not issue even an ever larger amounts of debt relative to the size of the economy and definitely, do you believe that the current level of debt is harming the economy?

Mr. ELMENDORF. The current level of debt is reducing our output, our incomes relative to what would be the case if we had a lower level of debt. Leading aside the effects of this particular recession which complicate that; but over the longer period of this sort of analysis, higher levels of debt are certainly more damaging than lower levels of debt.

Mr. STUTZMAN. Do you think that the discussion about tax increases keeps money on the sideline as well, without encouraging economic growth?

Mr. ELMENDORF. I think Congressman, that uncertainty about federal policy is diminishing household and business spending and that uncertainty covers a whole set of policies. I think it covers tax policy, it covers regulatory policy. Covers health policy, I should say we think the more important source of uncertainty is household and businesses uncertainty about their own incomes and the demands for their products, apart from government policy. But we think government policy is probably playing some role.

Mr. STUTZMAN. And you know I agree with and I think what families are doing is that they are doing what they can control and that is cutting their own spending in their own budgets; controlling their budgets. They cannot necessarily control the income revenue because the job market is tough. They cannot go take on more debt, because it is tough to borrow, and it is not necessarily wise to do so. So, I hear in this committee, you know that we only want to cut spending. I know you have been in this job for about two and a half years or so, when was the last time Congress talked about cutting spending and actually did cut spending in Washington?

Mr. ELMENDORF. Well, so as you know Congressman, the Appropriations Bill that was passed this past Spring reduced spending to what would have occurred.

Mr. STUTZMAN. Before that. I do not keep a list of that to be honest. I think there is a whole variety of proposals that have been enacted into law that include combinations of spending cuts, spending increases, tax cuts, tax increases, I am not even sure how I would keep such a tally.

Well I just do not understand why does it seem like it should be out of the realm of cutting spending, addressing everything; whether it is entitlements, whether it is discretionary, non-discretionary spending, military. I mean I believe everything should be on the table and from your analysis in the report is that we need to be very cautious in, or that the debt that we hold is damaging or is holding back the economy. I think everybody agrees that higher taxes, just the discussion of it, holds money on the sideline. So cutting spending should be a part of the discussion. Did you score the Affordable Health Care Act?

Mr. ELMENDORF. Yes, we did.

Mr. STUTZMAN. There was a report yesterday about a glitch found in the bill that is going to send roughly three million middle income Americans into Medicaid. Can you touch on that?

Mr. ELMENDORF. Yes, Congressman. So I do not know whether it was a glitch in the drafting or an intent of the drafting but in any case, our estimate of the bill incorporated the effects of that provision as it was written.

Mr. STUTZMAN. Well, what do you think that is going to do to three million middle income Americans trying to find confidence in the economy, finding confidence in Washington. If we continue this sort of, I mean, I am not blaming you because, but the intent obviously was there or for some reason it was there and now we are finding out after the fact and what it is going to do to effect at least three million Americans possibly.

Mr. ELMENDORF. So I should say, we do not have an estimate of the number of people who are affected. We took the definition of income eligibility into account in our estimate, but we do not have any separate count of how many people were affected by that piece of the definition, and in fact that is not really an answerable question it depends what else you might have changed other places in the law. So I do not want to endorse the three million, I have seen that number but that is not from us. All I can say is that we have this in our estimate, is not a surprise to us that it is there.

Mr. STUTZMAN. So this glitch is not a surprise to CBO?

Mr. ELMENDORF. No, it is not. Again, I do not know if it is a glitch or an intent but we read that piece to the legislation and used that language in our estimate.

Mr. STUTZMAN. That is what it seems to be called and that there is some backtracking by some folks here that this is a glitch and that, "Oh we did not recognize what happened here." You know, that is I appreciate your answers because you have been very you know balanced in I think approaching this because if we do not start talking about cuts and you know your report obviously gives us, I mean it is not so rosy a picture I do not believe and we have a lot of work to do in that we have to control what we can control, and that is cutting spending without doing further damage to the economy. But I believe tax increases; more borrowing is detrimental to our long term outlook. Would you agree with that?

Mr. ELMENDORF. I believe that more borrowing is detrimental to our long term outlook and I believe that higher marginal tax rates are also detrimental to the long term outlook, and that is why we tried to capture both those effects, where they were relevant in our economic analysis in this report.

Mr. STUTZMAN. Okay. Thank you very much.

Chairman RYAN. Mr. Tonko.

Mr. TONKO. Thank you for joining us here today Dr. Elmendorf and clearly these are days where your expertise is tremendously needed so, again welcome. If I could just return briefly to Mr. Yarmuth's line of questioning. Is it reasonable to assume that education spending impacts economic growth?

Mr. ELMENDORF. Yes, I think so Congressman.

Mr. TONKO. And what about our investment or spending on basic infrastructure, the roads, the bridges, the connections we need, the infrastructure to move people and goods around the country?

Mr. ELMENDORF. So we have done some analysis of infrastructure investment, and obviously there were some aspects of that investment that have been more beneficial to the economy and some that have probably not been beneficial at all; but on balance, sensible investments in public infrastructure, investments that pass some sort of benefit cost test, enhance economic growth.

Mr. TONKO. Asked another way, is there any reason to believe that we might see an economic dip if we do not do some of the investments in education and infrastructure?

Mr. ELMENDORF. So I think, well the term dip to me implies a sort cyclical effect, and a sharp cut in spending or increases in taxes in the short run would, as I have said before, I think cause that sort of dip, but usually for people, conversations about education or infrastructure are thinking more of the longer term and

I think reductions in the amount of education that occurs in the country, reductions in infrastructure that we build would be detrimental to long-term economic growth.

Mr. TONKO. And what about our unemployment, which I have read has a return in economic activity, that somewhere we are between $1.60 to $1.70 on every dollar spent on our unemployment insurance?

Mr. ELMENDORF. So we think that in the short run, in the situation of our economy now, where they are a lot of unemployed workers and underutilized factories and equipment; that putting money into the spending stream through benefit payments or reductions in taxes encourages more spending, and that leads to more output and more employment. And in our estimates the effects of putting money into unemployment insurance is especially powerful because the people who receive it tend to spend a very large share of it since they are people who have lost their jobs and in many cases do not have other sources of income.

Mr. TONKO. It seems as though the economic activity that we need to inspire would at least help those that are in that unfortunate realm. Can we bring up the charts that we have on the long-term debt. There we go. This chart is from Summary Figure One I believe, in it you present, Dr. Elmendorf, two projections of where our debt is headed in the next 30, maybe 35 years. Under both scenarios debt continues to grow relative to the size of the economy but there is a tremendous difference between these two line graphs. Where do we end up at the end of the chart in 2035 under each scenario in this chart?

Mr. ELMENDORF. So under the extended baseline scenario, which largely follows current law, we end up with debt at 84 percent of GDP. Under the alternative fiscal scenario, which more closely corresponds to current policy settings, we end up with debt at 187 percent of GDP in 2035.

Mr. TONKO. Thank you. And can you briefly summarize the key policy choices that differentiate the two scenarios?

Mr. ELMENDORF. Yes, so the biggest difference is on the revenue side, under current law because of the expiring tax provisions, provisions of last year's health legislation, just the natural interaction of the tax code with economic growth, revenues rise quite a bit relative to GDP. Under the alternative fiscal scenario, we hold revenues, we assume that these expiring provisions are instead extended and keep revenues down closer to their historical average share of GDP. So in 2035, revenues under the extended baseline scenario are 23 percent of GDP and on the alternative fiscal scenario are 18 and a half percent of GDP. There are also differences on the spending side, in both the health programs and the non-health, non-Social Security part of the budget. In the health programs we are principally assuming under the alternative scenario that some of the cost control features of last year's legislation do not continue over the entire quarter century we are showing here, and on the other non-health care, non-Social Security spending we are assuming still a very substantial decline relative to historical experience but not quite as stark an end of point as under the extended baseline scenario.

Mr. TONKO. To summarize one scenario sticks to current law and puts the debt at about 80 percent of GDP in 20 or so years. While the other scenario puts that debt at 180 percent of GDP by, among other things, extending tax cuts for the wealthy and refusing to implement the Affordable Care Act. That sounds, to me, to be an awful lot like the Republican agenda this year; and my concern is that you know we are wasting month after month on policies supported by the majority that are merely digging us into a deeper hole. Regardless of how you feel about that best strategy going forward, I think we can all agree that we need to do far better.

Chairman RYAN. Gentleman's time is expired.

Mr. TONKO. Thank you Chairman.

Chairman RYAN. I ask the gentlemen get back to him in writing if he wants you to do so. Mr. Woodall.

Mr. WOODALL. Thank you Mr. Chairman. Thank you Dr. Elmendorf for being here. I want to talk a little bit about cost containment. I am one of the freshmen here. In all of the modeling that you do, can you point me to some of the other areas where the government has been successfully involved in cost containment, other industries, or other product lines, that I could look at to see our success at cost containment?

Mr. ELMENDORF. So that is a good question, Congressman. I do not know of other parts of the federal budget, other parts of the economy, whether or not our government plays as large, parts of the economy as large as health care, where the government plays as large a part as it plays in health care.

Mr. WOODALL. For example I know we are spending more, a larger proportions of Americans are, on food stamps this year than have ever been on food stamps historically. Are we involved in any kind of cost containment, because I know the price of food with that Ethanol tax credit and what not, the price of foods gone, food inflation is rising dramatically. Any cost containment programs going on?

Mr. ELMENDORF. Not that I am familiar with Congressman. Of course, as you know, the principal reason why that cost of food stamps is so high is because the economy is weak and many people are out of jobs.

Mr. WOODALL. Well if there are no good cost containment examples, I know you were talking with Mr. Huelskamp earlier about efficiencies in the market place and how to squeeze some efficiencies out. Are there any industry sectors you can point me to where the government has really been a driver in creating efficiencies, because the private sector was not succeeding at that and so we have really got a great efficiency program run by the government?

Mr. ELMENDORF. Well Congressman, so if one turns to, if you have it in front of you, Table 3-1 in the report, it is on page 42, we report excess cost growth in spending for health care, and if one looks at that table one can see periods where in fact federal spending on health care and Medicare/Medicaid has increased more slowly than private health care spending. There are other periods where the opposite has been true, as I said in response to an earlier question, so I think that just looking within the health care system, the verdict on whether the private or public sector is better at controlling costs is not self evident from this table.

Chairman RYAN. Would the gentlemen yield on that point? I am looking at Table 3-1, I see of the four time periods you have measured, other meaning private health plans have lower cost growth than Medicare. There is one of the four periods where Medicare is lower, which was the period of Managed Care, than the private sector; all other is lower in cost growth than Medicare. Am I misreading this chart?

Mr. ELMENDORF. Well, I am sorry Table 3-1.

Chairman RYAN. Table 3-1, yes table 3-1.

Mr. ELMENDORF. So these are overlapping periods, I would emphasize. So in the 1985 to 2007 period, the last 22 years I guess leading up to this latest downturn, Medicare/Medicaid spending growth was a good yield below spending growth in the private sector. And as I emphasized earlier I do not want to pick a particular row out of this table.

Chairman RYAN. Yeah but then you have 1990 to 2007, it is 1.6 Medicare all other 1.5 percent.

Mr. ELMENDORF. That is right, so over the last 17 years, Medicare's been slightly above all other, Medicaid's been below that. So, what I am suggesting is that drawing conclusions about which system is better, I think you cannot draw those straightforwardly out of just a look at some historical tabulations like this. And that what makes this analytic challenge that we face difficult.

Mr. WOODALL. And I am not so much trying to draw a conclusion about which is better. I am trying to draw a conclusion about where the efficiencies are created. I mean would you say that when you have the government purchasing almost half the health care in this country, we can just tell folks we are going to pay less. That does not actually create efficiency, I mean. Does your modeling suggest that efficiency is why you see these numbers change? Or does your modeling suggest it is just the legislative changes, because we are not going to pay you? Are there successes that the government is experiencing that the private sector is not experiencing on the efficiency side? The price controls clearly they are far successful if they are done by the government.

Mr. ELMENDORF. So I think whether one views paying providers less as an efficiency measure or not, is a hard thing. I think there are health analysts who point to the experience of European countries that pay providers less for health care than we do. And they view that as an appropriate way to proceed. And we are not here to make recommendations, as you know. So, I am not sure, I think the word efficiency means different things to people in this context.

Mr. WOODALL. Let me go briefly to a different topic. You talked about certain forms of government spending that are important to economic growth. Did you actually mean certain forms of government spending? Or just certain forms of spending? Would you actually point to areas of spending that are more valuable if done by the government, done by the federal government, than if done by a state or local government or if done by an individual?

Mr. ELMENDORF. That is interesting and a hard question, Congressman. The point I was trying to make before was simply that one should not view all forms of government spending as a drag on the future economy because there are some pieces that have returns. Whether they could be done better or more effectively in different ways, I do not know. Some of these things are, to say national standards or consistency across the country. One might think of the interstate highway system as an example of that. Others are more individual to particular parts of the country and maybe could be done more effectively at that level.

Chairman RYAN. Thank you. Mr. Blumenauer.

Mr. BLUMENAUER. Thank you, thank you Mr. Chairman. I would just like to follow up where we are in terms of government efficiencies. Have you done an analysis of the cost per patient for veteran's health versus national averages in the private sector?

Mr. ELMENDORF. We have done analyses of the veteran's health care system, Congressman. That is a good example to raise. The Veteran's Health Care System at this point and time provides a high quality care at low cost.

Mr. BLUMENAUER. At lower costs than the average. If we took prescription Medicare drugs, where the Veterans Administration actually negotiates prices; do they provide prices less than what people are paying in the private market?

Mr. ELMENDORF. They do, I want to caution Congressman, about the difficulties extrapolating from individual systems to the entire health care system.

Mr. BLUMENAUER. I appreciate that but I just want to say, with all due respect, that there are models that the federal government is doing now that are providing higher quality at less cost. In terms of food inflation, I would think part of that is that we are lavishly subsidizing corn production to burn unnecessarily where the federal government and Congress, which has blinked and not fixed it, and in fact we had a chance in this committee to vote against that, contributes to food inflation. But I want to go back to something that you said, that I had a little concern with, you mentioned in the course of your testimony that having money for food stamps actually tends to get into the economy, has a higher multiplier effect because people take it and they spend it very quickly. And then in terms of reaction to my friend where you were saying Social Security's not an economic driver. It would seem to me that that money that goes into the hands of our senior citizens is almost analogous to food stamps. The senior citizens in my district are much more likely to spend that Social Security dollar than some of the lavish subsidies that we have now that we have tried to trim back. I mean, are you really saying that that does not have substantial economic impact?

Mr. ELMENDORF. So, thank you for the chance to clarify this.

Mr. BLUMENAUER. Good, I am sure you wanted to.

Mr. ELMENDORF. The discussion we were having over here I think was about a long-term economic growth path that we show in Chapter Two of our report. And over the longer term, over the medium term and longer term, what matters most for economic growth is the supply of the factors of production. How many workers there are.

Mr. BLUMENAUER. Okay, you are talking about growth not immediate.

Mr. ELMENDORF. How much saving capital there is. In the short term, particularly in an economy like ours now, with a lot of unemployed resources, then the principal determinant of the rate of economic growth is the demand for goods and services, and that is why I have said and others have said, that cuts and spending today and increases in taxes today, would tend to slow economic growth.

Mr. BLUMENAUER. Super, I appreciate the clarification. That is very helpful for me. I guess I would like to just conclude in one area that you referenced that other countries spend far less than the United States, actually almost every developed country spends dramatically less than the United States and if you are old fashioned, you look at things like life expectancy, child mortality, indicators that the rest of the world use to look at health care quality. It appears that they provide on average better outcomes for far less cost. I wanted to ask a question with that factual basis.

I do not think anybody disputes the numbers that we have been provided although some may dispute what they want to say is the best care, but I am just trying to get at the sense of is there something intrinsically, about the United States that would prevent us from being able to take to scale reforms within the existing system. I come from a state that is low cost, high quality for Medicare; and if everybody practiced medicine the way they do in my community, or in Wisconsin, we would not have the crisis we are facing. Is there something intrinsic about the economic system that would prevent us from being able to nationalize better quality different practice patterns?

Mr. BLUMENAUER. I think there is a lot of potential in our system to do much better than we are doing Congressman. I think the question at hand has been what is the best institutional framework to encourage those sorts of changes? As you point to a foreign health care system, you are certainly correct they spend less money than we spend, and have in many cases better health outcomes. The thing I was going to be, wanted to be more careful about and what you said was, what would have to measure of health care quality, it is more complicated because they are a variety contributors to health, health care is part of that, so is lifestyle differences. And in analyses of the treatment for specific sorts of conditions, in this system or other health care systems, it is less clear.

Chairman RYAN. Ms. Black.

Mrs. BLACK. Thank you Mr. Chairman and Dr. Elmendorf, thank you so much for being here today to give us this perspective of long-term budget outlook. I want to follow up on what Congressman Stutzman was talking about and he was going more on how debt is affecting individuals and families, and I would like to turn the attention a little bit in a different direction, on private investment. Because a private investment, obviously as we invest in jobs and different, new technologies and things of that sort, we grow the economy and when economy grows there is a need for more jobs. So, first I would like for you to talk a little about the crowding out affect, explain that, and then go to what level does government debt crowding out private investment become problematic?

Mr. ELMENDORF. So crowding out as you know Congresswoman, refers to the phenomenon that if there is more government debt being issued then a larger share of the private savings in the economy are devoted to holding that debt rather than going to investment and physical capital in plants and equipment that can make us more productive over time. And that is one of the large costs of rising debt is the cost that economists can best quantify so the cost that we quantify in this report, they are other costs of rising debt that we are not as good at quantifying that we write words about in the report, the more debt you have the more interest payments the government needs to make and that crowds out other kinds of spending, and requires higher taxes. The more debt you have the less flexibility you have to respond to emerging crises and the more debt you have the greater the risk of fiscal crisis itself. And so the, so for all of these reasons additional debt is a problem, for much of these effects there is no particular tipping point, every extra dollar of debt is a little bit worse, everything else equal. The one for which there may be a tipping point is this risk of a fiscal crisis, one might get to some particular level of debt but as we wrote in an issue brief last year, we do not think we can identify a particular level because it is not just the level of debt that matters, it is the expected trajectory of the debt. It is the confidence of investors in the governing process in a country to make changes in fiscal policy, it's the underlying strength of the economy and so on. So it is an awful lot of factors that matter, that is why we have been I think appropriately unwilling to identify some particular tipping point, and even in the well known work of Carmen Reinhart and Ken Rogoff on this subject, they do not really find a tipping point so much as they pick countries in a lot of debt and so they do worse than countries with less debt. But whether there is some threshold is not clear, and I think in fact if you talk with them they would say that it depends on all the factors of the country as well.

Mrs. BLACK. And just along those lines, I want to note that Figure 2-2 in your report does seem to indicate that government barring will have a negative effect on the economy in as little as just a few years and you do have that in your report, so I appreciate that and I think that we, given the fact that there is no tipping point as you say and there is no time limit where we can say ah definitely this is going to happen and what I appreciated so much is, we have had previous panel members who have indicated as sort of like a pond that you are skating on where you skate around the edges that are shallow and the ice is very thick and you feel very safe, but none of us know when that ice starts to get thin, the water starts getting deeper, and when we are going to fall through, and we just have to look to some of those countries that have already been in that situation where that debt can tip us at a point that would be unknown and could in many cases be very quick without us being able to respond. So, then I assume with the short period of time that I have left you would agree that the sooner that we address this debt issue the more safe we are going to be and the less likely we are going to be to look like those countries in Europe.

Mr. ELMENDORF. Congresswoman, I certainly think that the sooner that policy changes are agreed upon the safer the country will be in terms of the fiscal picture. The question of how quickly to implement the policy changes you agree upon involves tradeoffs that I cannot judge for you. The sooner that you act in terms of implementing changes, the less debt is accumulated and the more credibility is attached to the future cutbacks that have been discussed. On the other hand the sooner that government spending is cut or taxes are raised, the less time that individuals and businesses, state and local governments have to adjust to the changes, so the harder that transition will be for them and also changes implemented in the next few years will be hitting an economy that is all ready quite weak and we think weakening it further. So, there is a tradeoff in the sea of implementing these changes, I think in some ways that reinforces the risk of going up high levels of debt because one gets into a position where one is confronted with less and less palatable choices and I think that part of what you see in this tradeoff.

Mrs. BLACK. Thank you Mr. Chairman, I yield back my time.

Chairman RYAN. Mr. Pascrell.

Mr. PASCRELL. Thank you Mr. Chairman. Good morning. In the health care reform, Mr. Elmendorf, let's get back to that issue since it keeps on coming up, does it not. We passed what I consider to be significant savings, you know one-third of that legislation was devoted to Medicare and Medicaid; many of those savings were not scored for understandable reasons. That is not the issue here. In a large part, which is a large part of our deficit, we created innovative payments and delivery models. I am not telling you anything you have not heard before. That was the whole purpose, when people say we did not bring any changes, the Democrats, God bless you, who supported that legislation did not bring anything new to the table about entitlements, they obviously did not read the bill. But the majority's plan to stop these models and move everyone into the private market, oh that is a brilliant idea, pre-1964, very effective. If we look at the private market costs rose in 2010, it is interesting now you only went to 29 Mr. Chairman, my good friend. 2010 shows a very different situation. In 2010 costs rose 7.75 percent, the cost of health care compared to Medicare cost rose by 3.3 percent. That is in the Standard & Poor's indices of 2010. That is before three-quarters of the health care bill even went into effect, or four-fifths. So the point about what costs more and how we can save money, let's take a look at the facts.

And we will improve the legislation, but to do away with the legislation I think would be very hurtful to the economy and particularly those who are not covered. And particularly those who are losing their job, and we obviously Mr. Elmendorf did not get the forecast correctly about the economy in 2008, or 2006, or 2004, because in 2001 and 2003, when we made those dramatic cuts, tax cuts, and I am not singling out any group, but when those cuts were made, what were the plans, what was the forecast of why we were doing this, and what the results would be? And then what were the results? Did we have the business investments that my good Ms. Black talks about? Did we have an increase in jobs? No, in fact if you look back over the last four decades, four decades, the only president that has substantial increase in job investment and when the economy stood strong was Bill Clinton. Carter did not do it, 3 percent increase and business investment under Jimmy Carter. 3.4 percent under Ronald Reagan, under Bush I and Bush II, President

Bush, President Bush II we got an increase about 3.5 percent, 3.6 percent. They actually did a better job than Ronald Reagan. And under Bill Clinton 10.2 percent in those eight years he was the president of the United States, business investment. So tax cuts are not the panacea that we all are pretending it is. Is it Mr. Elmendorf?

Mr. ELMENDORF. Well, Congressman I think the variety of influences on the economy, the policies of presidents and congresses are obviously important. A lot of other things are important as well. I would be loathe to draw any strong conclusion from the period averages that you suggest.

Mr. PASCRELL. They are pretty accurate.

Mr. ELMENDORF. I am not disputing the numbers I am just stating that to map those directly to the policies of those presidents, I think involves leaving out all the other factors that matter.

Mr. PASCRELL. There are other factors are there not Mr. Elmendorf. So, when Obama raised his hand, when the president raised his hand in January, 2009; he had no idea, we had no idea, of how bad this economy was. Would you agree to that?

Mr. ELMENDORF. Yes I do Congressman.

Mr. PASCRELL. Thank you, for the record, Mr. Chairman.

Chairman RYAN. All right, thank you Mr. Pascrell. Mr. Garrett.

Mr. GARRETT. And I thank the Chairman. So taking a page out of Mr. Pascrell's comments I guess, but not with the same tone and forcefulness. So it is hard to make these projections, that you make over time.

Mr. ELMENDORF. It certainly is Congressman.

Mr. GARRETT. There you go. So, when you make these assumptions, or when you take in the assumptions to make these projections, what do you do, quickly, with regard to your assumptions with regard to the overall capital market structure in this country, euphemistically Wall Street and investments, and what have you? How does that play into it?

Mr. ELMENDORF. So private saving matters, that is the is the source of funds for investments, to the extent that is not crowded out by additional debt, and we assume that private saving continues over time and away, that keeps interests rates about stable, under a benchmark and then we do other things for the particular policy scenario.

Mr. GARRETT. So within that for example, do you take in assessments so you study to look at to see where the capital markets, where the proverbial trillion dollars on the sidelines, or whether that is being invested or not, that sort of things that you look at?

Mr. ELMENDORF. For this sort of longer term analysis we are looking more at 40 year or 30 year or 20 year averages, when we look to our projections. For our near term economic projections, the ones we are updating for August, we are most definitely looking at the current state of capital markets.

Mr. GARRETT. So you hear Chairman Bernanke say, a week or two ago, some statement where he said, he was asked by Jaime DiMon, did they, the FED, look into and consider what the cost of all Dodd Frank at all is on the market place and he said, no, it is just too complicated for us to do. You heard that?

Mr. ELMENDORF. I have heard that.

Mr. GARRETT. But have you? Is it too complicated?

Mr. ELMENDORF. We have also not tried to quantify the effects of that legislation on the system of the economy.

Mr. GARRET. A. Is that something that you are able to do? and B. Is that something you should be doing?

Mr. ELMENDORF. I do not think we have the capacity to do it Congressman. Ideally, yes I think it is an interesting question.

Mr. GARRETT. Well I mean, more than interesting, but does not that sort of drive part of the cost as far as the economy going, as going forward?

Mr. ELMENDORF. I think it is certainly a factor in economic growth.

Mr. GARRETT. So then he said at a press conference I think it was last week, he said he is seeing some sort of soft spots in the economy, right. And he said he does not quite understand, he is sort of clueless if you will as to why that soft spot. In other words, he had his projections like you did too, going forward, doing all those things with QE-1 and QE-2. He thought we were going to at certain places on GDP and growth and unemployment but we are not there. You saw that comment?

Mr. ELMENDORF. Yes.

Mr. GARRETT. Yeah, so could that be part of the problem though? That if both you and he are failing to have that bit of information as far as what the cost of regulation and implementation of it is to the economy, that that could be explaining on some of our charts of where the problems are?

Mr. ELMENDORF. It could be a factor Congressman. I mean they are an awful lot of things that we do not have in our models and our models do not model very well.

Mr. GARRETT. Capital markets I would think it would be a pretty big factor in as far as, I mean that is one of their two responsibilities in job growth. Just quickly another point. That is true is it not?

Mr. ELMENDORF. So capital market are important then Congressman, yes.

Mr. GARRETT. So I came in and I heard you say a couple of times, I may paraphrase. You said sharp cuts right now and tax increases now would slow economic growth or words to that effect.

Mr. ELMENDORF. Yes that is right Congressman.

Mr. GARRETT. Can you quickly define for me what are sharp cuts in spending?

Mr. ELMENDORF. So I was trying to convey with the word “sharp” was some sense of the magnitude of the cut or increase relative to the size of the economy. So we have an economy even in its weakened state, has GDP of $15 trillion, policies that move that have to be significant.

Mr. GARRETT. Can you define that for me?

Mr. ELMENDORF. No because there is no cut-off per say. It is a question of degree.

Mr. GARRETT. If we cut $100 billion out of the 2012 budget is that a sharp cut?

Mr. ELMENDORF. That is enough of a cut that it would affect our projections for GDP growth over the next few years, yes Congressman.

Mr. GARRETT. A $100 billion would, to what extent?

Mr. ELMENDORF. Well it depends on exactly what you change right, so the analysis that we have done of the Recovery Act and of alternative policies for increasing output in employment show a range of different effects depending on the specifics of the policy. Which I think is the analysis you want us to be doing. Not just a matter of dollars, it is a matter of what is in the policy.

Mr. GARRETT. What percentage is that, 100 of that $15 trillion account?

Mr. ELMENDORF. So the economy is $15 trillion.

Mr. GARRETT. You are good with numbers.

Mr. ELMENDORF. One percent of that is $150 billion, so $100 billion is two-thirds of a percent to the economy. For some forms of changes in government policy, the effect on the economy could be less or more than that, but two-thirds of a percent is not trivial, the downward revisions in Federal Reserve's forecast that got some coverage yesterday for this year's economic growth are less than that.

Chairman RYAN. So two-thirds, so about a .66 percent cut in spending in your model slow down the economy right now?

Mr. ELMENDORF. Yes, I think all the models try to capture, even the small effects, which I was trying to convey with the term sharply.

Chairman RYAN. I find that interesting. Ms. Wasserman Schultz.

Ms. WASSERMAN SCHULTZ. Thank you Mr. Chairman, I want to just follow up on that same line of questioning that Mr. Garrett had. So if we are assuming that a $100 billion cut could affect the growth of the economy demonstrates that what even seems like a small percentage cut would have a significant impact. That seems backed up Mr. Elmendorf by Chairman Bernanke who said in an article in Politico today, that "I do not think that sharp immediate cuts in the deficit would create more jobs. It would be best not to have sudden and sharp fiscal consolidation in the near term." So we have more than one of our economic experts it seems pointing to the danger of cutting too much too fast. So generally are you concerned that the proposed, what I term reckless, but the proposed Republican budget cuts at the pace that they have proposed them, and the amount and size that they have proposed them would negatively impact our ability to recover?

Mr. ELMENDORF. So Congressman, I agree with Chairman Bernanke's statement. We have not done an economic analysis of the Republican budget resolution. As I have said earlier on other occasions, near term cuts in spending or increases in taxes, under the current economic conditions would slow the economy. Credible reductions in future deficits from future spending cuts or tax increases would boost confidence, lower interest rates, and thus strengthen the economy today. So I think the effects of an overall fiscal package on today's economy depends on the balance of, and the timing of the changes and policies.

Ms. WASSERMAN SCHULTZ. So does it make more sense in terms of making sure that we pace ourselves on trying to strike that right balance to use a chisel when it comes to cuts, to make sure that we have the right combination of investments and cuts, so we do not upend the apple cart?

Mr. ELMENDORF. From our analysis there are tradeoffs in the speed of the fiscal consolidation, it is a term of ours. The faster one moves, the less debt is accumulated, the better that is in the long run, and the more credible future promise cuts would be, which is good for the short run. On the other hand, the faster that policy moves, the less time people, businesses, other levels of government, have to adjust and the bigger the hit on the economy, in the short term. So there is a tradeoff there that all we can do is to try to elucidate that tradeoff, but it is up to you and your colleagues to judge how to proceed.

Ms. WASSERMAN SCHULTZ. Right, thank you. I want to shift to Medicare in just the last couple of minutes that I have. CBO's analysis of the voucher payment in Mr. Ryan's plan in 2022 says that basically it is equal to what a 65-year-old would cost in traditional Medicare. My question is, does that mean that at least in the first year of the program, that the voucher does not really save the government any money? And doubles the out-of-pocket costs for the first 65-year-olds to be covered under the plan? Am I understanding that correctly?

Mr. ELMENDORF. Congresswoman, we did not actually study the proposal in the first decade. We do not usually study budget resolutions, we analyze the longer term implications as we have with other plans of the Chairman's. And also we need to distinguish between federal costs and total costs. So by our analysis it is more expensive to treat a 65-year-old through private insurance, than it is to treat that person through Medicare today for a typical 65-year-old. But the plan also, over time reduces the federal government's payments. So we show over time, the plan reducing federal payments relative to the existing Medicare system, and but we also show as you know beneficiaries paying more.

Ms. WASSERMAN SCHULTZ. Paying more; and just my final 30 seconds. Your analysis also on page 13 indicates that the reality of the proposal is that some people would not actually purchase insurance because of the extra cost that they would face, so does that mean that we could actually see an increase in the rate of elderly who are either uninsured or underinsured? And would have to spend a substantial amount of their income on health care to make up for the difference in what the coverage used to be?

Mr. ELMENDORF. Congresswoman, you might see an increase in people running short. We were not able to analyze that and I think that is a very important question, and one of a number of significant caveats to that analysis. We, in another context as you know, we have studied participation decisions given a set of rules the government would put in place, we just have not been able to do that for this proposal. It raises the risk of people, more older Americans over the age of 65.

Ms. WASSERMAN SCHULTZ. And it changes the safety net that exists now under Medicare for seniors.

Mr. ELMENDORF. It is a very different world than the world that exists under the traditional program today. Yes Congresswoman.

Ms. WASSERMAN SCHULTZ. Thank you Mr. Chairman. I yield back.

Chairman RYAN. Right on time. Last speaker, Mr. Ribble.

Mr. RIBBLE. Doctor, it is good to see you again.

Mr. ELMENDORF. Good to see you Congressman.

Mr. RIBBLE. Going back to my colleague's question on would we lose more people in health care because they would not have the money to buy the difference. If our plan actually directed funds more toward lower and middle income, as opposed to wealthy millionaires and billionaires, would not we in fact maybe improve the circumstance with those being insured?

Mr. ELMENDORF. If we were able to analyze the participation decision, you are absolutely right Congressman. We need to take into account the levels of subsidies for different groups of Americans and how that fits with their own resources, that is part of what that analysis would be.

Mr. RIBBLE. And helping poor Americans and middle class Americans is a good idea.

Mr. ELMENDORF. Well it is not my place to make a value judgment, but certainly the additional subsidies for lower income people would increase their participation relative to a world without the subsidies.

Mr. RIBBLE. I would like to come, circle back to this mystical, magical, $100 billion in cuts and the impact on the economy.

Mr. ELMENDORF. Yes.

Mr. RIBBLE. Assuming that the federal government's not actually borrowing that money, where else does the federal government get that money from?

Mr. ELMENDORF. Well, so it comes from either borrowing or tax revenue Congressman.

Mr. RIBBLE. Sure, let's assume it is coming from tax revenue, either from a higher taxes or we are just taxing it. So how does taking money from one sector of the U.S. economy, i.e. the consumer, and giving it to another sector of the economy, i.e. the government, change the number of dollars circulating in the economy?

Mr. ELMENDORF. Well, I think the policy scenario that we were talking about was a cut in spending that was not matched by an equal cut in taxes. So it is a cut in spending that will lead to a reduction and borrowing and that has various advantages as I have said, but it is also true by our analysis and I think the analysis of many economists with that reduction in spending is some American who is not getting a benefit payment or it is some American business that is not getting a contract and that reduction in the government's money pushed into the economic system reduces the spending of the households or businesses that would otherwise get it and with that reduction demand slows the economy relative to what would otherwise happen.

Mr. RIBBLE. Unless of course we took the money from some consumer who might spend it on their own, based on their own free choice. Maybe they buy it from a cool roofing contractor like my company instead.

Mr. ELMENDORF. Well so again Congressman, it depends on the policy scenario when its envisioning, but I think the question, if I understood the question, it was a reduction in spending not matched by reduction in taxes; and that means partly, it depends what the nature of the spending cut is, but it means that somebody is not getting a check that they would otherwise be getting either as a benefit payment or in payment for a service provided to the government.

Mr. RIBBLE. And I might not also be getting a tax that otherwise would have.

Mr. ELMENDORF. Well I think that the expectation of future taxes, again in this scenario taxes are not being exchanged right away, but people's expectations of future taxes would probably be different and that matters as well. And that is why I emphasize that credible reductions in future deficits through lower spending or high taxes would have confidence building effects on people. And why our modeling incorporated the effects of tax rates on people's behavior.

Mr. RIBBLE. Because in your report you saw that long term budget, I am on page four, CBO's projection in the most of the 2011 long term budget outlook, understates the severity the long term budget problem because they do not incorporate the negative effects that additional federal debt would have on the economy nor do they include the impact of higher tax rates on people's incentives to work and save. Which I think is significant. And then going on to the next page, you say growing debt would also increase the probability of a sudden fiscal crisis. And I wonder if you could talk to me because it is simple to look at what sudden is and what crisis is but what does sudden and crisis mean to you. How fast is sudden, and how big is the crises?

Mr. ELMENDORF. So first let me emphasize that in most of the projections in the report, hold the economic conditions fixed for a comparison across policies. We do in Chapter Two do an extended analysis of the effects of these policies on the economy. Sudden fiscal crises in other countries, have come on in a matter of months, or weeks, or days; and they have generally had very disruptive effects on those economies because governments are suddenly forced to make the sorts of decisions that they had put off for the years leading up to the crisis. And those threats of sudden adjustments particularly at a moment when the economy is all ready under siege if you will are particularly difficult and particularly painful and particularly detrimental to economic conditions.

Mr. RIBBLE. And I will make just one final comment then I will yield. You say also during which investors' would lose confidence on the government's ability to manage its budget and the government would thereby lose its ability to vouch at affordable rates. I would dare say, based on the conversations I've had with American citizens in my district, that many investors and many Americans have a relative lack of confidence in this government to make the right choices.

Mr. ELMENDORF. That may be true Congressman but if one looks to financial markets, the investors who are actually putting their money on the table are not charging our government high rates today, they are actually charging our government low rates at this point and that illustrates the risk of fiscal crisis which is things are fine until they are not anymore. And as we talk to people in financial markets, including in our panel of economic advisor's meeting a few weeks ago, the financial market participant were themselves a little surprised that financial markets were not more concerned that investors were not more worried. Their view was that most investors do in fact think that policy actions will be taken to put the government's budget on a sustainable path. And they at this point, those investors have confidence in that.

Mr. RIBBLE. And I hope we warrant that confidence and I'll yield back Mr. Chairman.

Chairman RYAN. Thank you. Thank you for indulging us. I know you were hoping to get out of here by noon and, pretty close to that so thank you. Hearing is adjourned.

[Whereupon, at 12:04 p.m., the Committee was adjourned.]

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