THE CONGRESSIONAL BUDGET OFFICE'S 2012 LONG-TERM BUDGET OUTLOOK

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

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CONTENTS

THE CONGRESSIONAL BUDGET OFFICE'S 2012 LONG–TERM BUDGET OUTLOOK

WEDNESDAY, JUNE 6, 2012

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, Cole, Price, McClintock, Stutzman, Lankford, Black, Flores, Mulvaney, Huelskamp, Young, Van Hollen, Doggett, Blumenauer, McCollum, Castor, Bonamici.

Chairman RYAN. The hearing will come to order. The committee will come to order. Welcome everybody to the Budget Committee. The purpose of this hearing is to review the Long-Term Budget Outlook, which CBO just recently released, and unpack the fiscal and economic damage in challenges facing our nation.

We are joined today by, no stranger to this committee, Doug Elmendorf, director of the Congressional Budget Office. I want to thank you again for testifying today, Doug, and for the work your team has done in putting together this report. The report is sobering and the warnings are dire. You write in the report, quote, "Growing debt 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," close quote. What is causing this growing debt? Government spending is on a breakneck pace. By 2025, according to this report, health spending, including Medicare and Medicaid, Social Security and interest on the debt will consume 100 percent of revenues, tax revenues that continue to increase each and every year. The problem, of course, is unsustainable increases in government spending. Our entitlement programs, in particular government spending on health care are the core drivers of the debt. As your report makes clear, the health care law fails to address the cost problem, and instead adds new liabilities to an already bankrupt future. Those unwilling to structurally reform a structurally broken government repeat the same calls for ever higher taxes to chase ever higher spending. On the question of taking more from hardworking taxpayers, CBO's report is clear, writing that that, quote, "The extent that additional tax revenues were generated by boosting marginal tax rates, those higher rates would discourage people from working and saving, further reducing output in income," close quote. CBO, like all non-partisan experts, has again warned of delay in solving our fiscal problems. Unfortunately, the administration has no definitive solution to the problem we face, but merely obstruction for those who do put forth good faith solutions. The Senate, of course, has not passed a budget in more than three years. House Republicans refuse to accept the European-style debt crisis which promises harsh austerity. We reject the empty promises and continued inaction in the face of a crisis. Cranking up tax rates that further stifle growth and harsh disruptions to beneficiaries is what Europe is doing right now. This does not have to be our fate. This is why we continue to advance gradual, common sense reforms to lift the debt, strengthen core priorities, and spur job growth. We still have a window of opportunity that will require us to come together to solve this problem. CBO has presented us with their analysis, but it is incumbent upon policymakers to respond to their findings with principled solutions. It is our moral responsibility to work together to chart a sustainable fiscal path, to revitalize economic growth and to expand opportunity now and for generations to come.

I want to thank you for coming again today Doug, we look forward to your testimony, and lots of questions for the members, and with that, I will yield to the Ranking Member, Mr. Van Hollen.

[The prepared statement of Paul Ryan follows:]

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

Welcome all to the House Budget Committee.

The purpose of this hearing is to review the Long-Term Budget Outlook, and unpack the fiscal and economic challenges facing our nation.

We are joined today by Doug Elmendorf, Director of the Congressional Budget Office. I want to thank you for testifying today, Doug—and the work of your team in putting together this report.

The report is sobering and the warnings are dire. You write, quote: “Growing debt 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.”

What is the cause of this growing debt? Government spending is on a breakneck pace. By 2025, health spending, including Medicare and Medicaid, Social Security and interest on the debt will consume 100 percent of revenues—tax revenue that continues to increase every year.

The problem of course is the unsustainable increase in government spending. Our entitlement programs—in particular government spending on health care—are the core drivers of the debt. As your report makes clear, the health care law fails to address the cost problem, and instead adds new liabilities to an already bankrupt future.

Those unwilling to structurally reform a structurally broken government repeat the same calls for ever-higher taxes to chase ever-higher spending. On the question of taking more from hardworking taxpayers, CBO’s report is clear, writing that to “the extent that additional tax revenues were generated by boosting marginal tax rates, those higher rates would discourage people from working and saving, further reducing output and income.”

CBO, like all non-partisan experts, has again warned of delay in solving our fiscal problems. Unfortunately, the Administration has no definitive solution to the problem we face, but merely obstruction to those who do put forth good faith solutions.

The Senate, of course, hasn’t passed a budget in more than three years. House Republicans refuse to accept the European-style debt crisis—which promises harsh austerity.

We reject the empty promises and continued inaction in the face of a crisis. Cranking up tax rates that further stifle growth and harsh disruptions to beneficiaries is what Europe is doing now. This does not have to be our fate.

This is why we continue to advance gradual, common-sense reforms to lift the debt, strengthen core priorities, and spur job growth. We still have a window of opportunity that will require us to come together to solve this problem. CBO has presented us with their analysis, but it is incumbent upon policymakers to respond to their findings with principled solutions.

It is our moral responsibility to work together to chart a sustainable fiscal path, to revitalize economic growth and to expand opportunity—now and for generations to come.

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

Mr. VAN HOLLEN. I thank you Mr. Chairman, I want to join the chairman in welcoming you Dr. Elmendorf and two weeks ago, you and your colleagues at the Congressional Budget Office released an analysis of the economic impact of the so-called fiscal cliff, painting a very somber picture of what might happen if Congress fails to address expiring tax cuts and the looming automatic spending cuts that occur at year's end. You predicted a possible recession early next year and millions more out of work if we were to actually go over that fiscal cliff. Yet your long-term outlook, CBO's long-term outlook, which we are discussing today, also confirms that continuing to do business as usual, extending all current tax and spending policies will produce unsustainable deficits and debt, which will also hurt the economy in the long run. Taken together, the two CBO reports reinforce the fact that Congress must adopt a two track strategy of one, acting now to boost a fragile economy and help put more Americans back to work, and number two, acting now to put in place a balanced approach to long-term deficit reduction that does not take resources out of the economy in the near term. This is the opposite approach of those who advocate for immediate, steep austerity measures. The type of measures that have been pushed by some of our European partners like the UK and put them back into a recession. On the first step, putting Americans back to work, we need to enact the President's jobs plan that the White House sent to Congress nine months ago. That proposal includes significant new investment in building roads, bridges, transit ways and other needed infrastructure. At a time of over 14 percent unemployment in the construction industry and super low interest rates, this should be a no-brainer. We call upon Speaker Boehner to put the President's job proposal to a vote on the floor of the House. The second step is for lawmakers, the Congress, the President, to adopt the plan to reduce the deficit By applying the kind of framework of spending cuts and revenues generated by eliminating certain tax breaks, that has been recommended by bipartisan groups, like Simpson-Bowles. That plan should extend taxually for working families and replace the sequester with a balanced approach to deficit reductions so our economy does not go over the fiscal cliff. Unfortunately the Speaker's threat to let the nation to default on its debt if Republicans cannot impose their European-style austerity plan is cementing the view in capital markets that lawmakers will fail to reach an agreement before the end of the year. That manufactured crisis creates uncertainty that will undermine confidence and weaken the economy. The Standard & Poor's downgrade of the U.S. credit rating last year was due to forecasts of continued political gridlock. And yet for many in the House of Representatives compromise remains a dirty word. Mr. Chairman, we look forward to having a willing partner willing to make the necessary compromises to both make sure our economy kicks into full gear and also develops a balance plan to reduce the deficit over the long term. Thank you.

[The prepared statement of Chris Van Hollen follows:]

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

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

Two weeks ago, the Congressional Budget Office (CBO) released an analysis of the economic effects of the 'fiscal cliff,' painting a somber picture of what might happen if Congress fails to address expiring tax cuts and the looming automatic spending cuts that occur at year's end: a possible recession early next year and millions more people put out of work. Yet, CBO's long-term budget outlook released yesterday also confirms that continuing to do business as usual—extending all current tax and spending policies—will produce unsustainable deficits and debt, which would also hurt the economy in the long run. Taken together, the two CBO reports reinforce the fact that Congress must adopt a two-track strategy of: 1) acting now to boost our fragile economy and help put more Americans back to work, and 2) acting now to put in place a balanced approach to long-term deficit reduction that doesn't take resources out of the economy in the near term. This is the opposite approach to those who advocate for immediate, steep austerity measures—the type of measures that have pushed some of our European partners like the United Kingdom back into recession.

The first step is to put Americans back to work. So we need to enact the President's job proposals that the White House sent to the Congress nine months ago. That proposal includes significant new investment in building roads, bridges, transit ways, and other needed infrastructure. At a time of 14.2 percent unemployment in the construction industry and super-low interest rates, this should be a no-brainer. I again call on Speaker Boehner to put the President's jobs proposals to a vote on the House floor.

The second step is for lawmakers to adopt a plan to reduce the deficit in a balanced way, by applying the kind of framework of spending cuts and revenues generated by eliminating certain tax breaks that has been recommended by bipartisan groups such as Simpson-Bowles. That plan should extend tax relief for working families and replace the sequester with a balanced approach to deficit reduction so that our economy never goes over the fiscal cliff. Speaker Boehner's threat to let the nation default on its debt if Republicans can't impose their European-style austerity plan is cementing the view in capital markets that lawmakers will fail to reach an agreement before the end of the year. That manufactured crisis creates uncertainty that will undermine confidence and weaken the economy. The Standard and Poor's downgrade of the U.S. credit rating last year was due to forecasts of continued political gridlock. Yet for many in the tea party movement, compromise remains a dirty word.

We've already enacted $1 trillion in spending cuts under the Budget Control Act and Democrats support additional, targeted spending cuts—provided these are accompanied by eliminating tax breaks for millionaires, Big Oil companies, and other special interests. In contrast, Republican budget proposals would hurt seniors and the most vulnerable while expanding tax breaks to the wealthy and fail any test of balance and responsibility.

We are told that within the next few months Republicans will vote to extend all of the Bush-era tax cuts, including those for millionaires. CBO's analysis shows that extending all of the cuts, including tax breaks for millionaires, will increase the long-term deficit and reduce long-term growth. Democrats support extending tax cuts for over 99 percent of Americans filing tax returns, while letting tax cuts for millionaires expire. Combined with additional loophole closing and base-broadening at the top, this proposal could reduce deficits by nearly a trillion dollars over this decade and by much, much more over the long haul.

CBO's long-term outlook shows that the aging of the population drives nearly 70 percent of the cost of Social Security, Medicare, and Medicaid. The Republican budget addresses federal spending by ending the Medicare guarantee for seniors, unloading the financial risk of future health care cost growth onto elderly and disabled individuals—all so they can expand tax breaks for the wealthiest individuals.

Unfortunately, we have yet to find a willing partner in our Republican colleagues. This is evidenced by Speaker Boehner's refusal to take up the President's jobs bill, the insistence on holding tax relief for 99 percent hostage to tax breaks for the top 1 percent, and the Speaker's threat to default on the obligations of the U.S. if we don't adopt the European-style austerity approach to the budget.

It's time for the GOP to put the needs of all American families ahead of millionaires and Big Oil companies, and meet Democrats half way to boost our economic recovery and get our fiscal house in order.

Chairman RYAN. Thank you, thank you Mr. Van Hollen. And I also ask that unanimous consent members have five legislative days to insert their statements in the record if they choose to do so. Dr. Elmendorf, the floor is yours.

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

Mr. ELMENDORF. Thank you Chairman Ryan, congressman Van Hollen, to all the members of the committee, I am pleased to be back today with you to talk about the Long-Term Budget Outlook. In the report that CBO released yesterday, we assessed that outlook under two very different sets of assumptions about future tax and spending policies. The extended baseline scenario reflect the assumption that current laws generally remain unchanged. That assumption implies that law makers will allow tax and spending policy changes that are scheduled to occur to actually do so.

In contrast, the extended alternative fiscal scenario incorporates the assumptions that certain policies that have been in place for a number of years will be continued. And that some provisions of law that might be difficult to sustain for a long period will be modified. Thus the scenario maintains what some analysts might consider current policies as compared with current laws. The budgetary and economic outcomes under these two scenarios would be starkly different. Under the extended baseline scenario, that is current law, federal debt would decline gradually relative to GDP over the next 25 years. From an estimated 73 percent this year to 53 percent by 2037. Though the outcome would not be dramatically different from our current situation, there would be a sharp change from the nation's historical patterns of taxes and spending. Revenues would rise steadily relative to GDP, owing to several factors. The schedule of expiration, of cuts in individual income taxes enacted since 2001, the growing reach of the alternative minimum tax, the tax provisions of the Affordable Care Act, the way in which the tax systems interacts with economic growth, demographic trends and other factors. Altogether, revenues would reach 24 percent of GDP by 2037, much higher than has been seen in recent decades. At the same time, federal spending on everything other than the major health care programs, Social Security and interest would decline to the lowest percentage of GDP since before the Second World War. That significant increase in revenues and decrease in the relative magnitude of other spending would more than offset the dramatic rise in spending on health care programs and Social Security. That is why debt would decline relative to GDP under current law.

In contrast, the outlook for debt is much bleaker under the extended alternative fiscal scenario. As I said, in that scenario, the assumption is that government maintains the kind of tax and spending policies that we have been accustomed to. In that scenario, all expiring tax provisions with the sole exception of the current reduction in the payroll tax rate are assumed to be extended through 2022. And after 2022, revenues are assumed to remain at their 2022 mark of 18.5 percent of GDP, just a little above the average of the past 40 years. On the outlay side, this scenario assumes that the automatic reductions in spending required by last year's Budget Control Act will not occur, that certain scheduled reductions in health care spending will not occur. And that federal spending on everything other than the major health care programs, Social Security, and interest would return to its average share of GDP during the past two decades.

Altogether, in the extended alternative fiscal scenario, revenues would be much lower, and non-interest outlays somewhat higher than in the extended baseline scenario. As a result, federal debt would grow rapidly from its already high level, exceeding 90 percent of GDP in 2022, and approaching 200 percent in 2037 because the extended alternative fiscal scenario is roughly representative of the fiscal policies that are now or have recently been in effect. The explosive path of federal debt under that scenario underscores the need for large and timely policy changes to put the federal budget on a sustainable course. I would like to take a few more minutes to highlight two specific implications of these projections. First, it is not possible both to keep taxes at their historical average share of GDP and to keep the laws unchanged for Social Security, Medicare, and Medicaid. The reason we cannot repeat that historical combination of policies is that the aging of the population and rising cost for health care have made those large entitlement programs much more expensive than they used to be. It is possible to keep taxes at their historical average share of GDP. But only by making substantial cuts relative to current law in the large entitlement programs that benefit a broad group of Americans at some point in their lives.

Alternatively, it is possible to keep the laws for the large entitlement programs unchanged, but only by raising taxes substantially on a broad group of Americans. Changes in other federal programs, besides the large entitlements can affect the magnitude of the changes needed in taxes or the large entitlements, but they cannot eliminate the basic tradeoff I have just described. Even if spending on all of those other programs, including national defense, and wide variety of domestic programs, fell with smaller share of GDP than we have seen since before the Second World War, debt would still be on an unsustainable upward trajectory without substantial changes in taxes, the large entitlement programs, or both.

The second implication of the projections that I would like to emphasize, is they are keeping federal deficits and debt no larger than we would project under current law would involve difficult policy tradeoffs. Under current law, as captured by the extended baseline scenario, we expect that debt will decline slowly relative to GDP in 2015 and beyond. Such a path for debt would gradually reduce the crowding out of private investment caused by high debt. It would restore lawmakers ability to use in spending policies to respond to unexpected domestic or international challenges. And it would reduce the risk of a sudden fiscal crisis, during which investors would lose confidence in the government's ability to manage its budget and the government would lose its ability to borrow at affordable rates. But even on that path, debt in 2037, 25 years from now, would still be larger relative to GDP than any year between 1956 and 2008.

So that path for federal debt might not be optimal. In fact, analysts do not know what level of debt is optimal. But it is one path that might be considered a plausible goal for federal policy. Obtaining that goal though would pose some significant tradeoffs. Tradeoffs that are exemplified by the decisions confronting you as the various provisions of law expire or take effect at the end of this year. To keep the nation on that current law path of declining debt, any actions by the Congress that would significantly worsened the budget outlook relative to current law would need to be offset or paid for by other actions that would improve the budget outlook by a comparable amount.

For example, removing the automatic spending reductions under the Budget Control Act would raise deficits by about a trillion dollars over the next decade. And extending all of the 2001 and 2003 tax cuts and indexing AMT for inflation would raise deficits by about $4.5 trillion over the next decade. Both figures excluding the effects on debt service, I should say. Making such changes to current law while maintaining the same path of declining debt as under current law would require other changes in policy that would reduce deficits by roughly $1 trillion or $4.5 trillion. To be sure, the Congress might not enact those changes in law, or it might choose to allow more debt that would occur under current law, or alternatively, to reduce debt more quickly relative to GDP than would occur under current law.

There are many possible combinations of policies you might pursue, and CBO will make neither recommendations nor predictions about them. My point is simply that the path of debt under current law would still leave debt at a historically high level relative to GDP. And yet, achieving even that path would require very large changes in current policies. You and your colleagues, and all of us, as American citizens, face hard choices. Thank you, I am happy to take your questions.

[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 on the Congressional Budget Office's (CBO's) most recent analysis of the long-term outlook for the budget and the economy. My statement summarizes the report The 2012 Long-Term Budget Outlook, which CBO released yesterday.

In the past few years, the federal government has been recording the largest budget deficits since 1945, both in dollar terms and as a share of the economy. 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 (gross domestic product, or GDP)—a little above the 40-year average of 38 percent. Since then, the figure has shot upward: By the end of this year, CBO projects, federal debt will exceed 70 percent of 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 caused by the severe economic downturn and from policies enacted during the past few years. However, the growing debt also reflects an imbalance between spending and revenues that predated the recession.

Whether that debt will continue to grow in coming decades will be affected not only by long-term demographic and economic trends but also by policymakers' decisions about taxes and spending. The aging of the baby-boom generation portends a significant and sustained increase in the share of the population receiving benefits from Social Security and Medicare, as well as long-term care services financed by 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 uncertain). Without significant changes in government policy, those factors will boost federal outlays relative to GDP well above their average of the past several decades—a conclusion that holds under any plausible assumptions about future trends in demographics, economic conditions, and health care costs.

According to CBO's projections, if current laws remained in place, spending on the major federal health care programs alone would grow from more than 5 percent of GDP today to almost 10 percent in 2037 and would continue to increase thereafter.[1] Spending on Social Security is projected to rise much less sharply, from 5 percent of GDP today to more than 6 percent in 2030 and subsequent decades. Altogether, the aging of the population and the rising cost of health care would cause spending on the major health care programs and Social Security to grow from more than 10 percent of GDP today to almost 16 percent of GDP 25 years from now. That combined increase of more than 5 percentage points for such spending as a share of the economy is equivalent to about $850 billion today. (By comparison, spending on all of the federal government's programs and activities, excluding net outlays for interest, has averaged about 18.5 percent of GDP over the past 40 years.) If lawmakers continued certain policies that have been in place for a number of years or modified some provisions of current law that might be difficult to sustain for a long period, the increase in spending on health care programs and Social Security would be even larger. Absent substantial increases in federal revenues, such growth in outlays would result in greater debt burdens than the United States has ever experienced.

LONG-TERM SCENARIOS

In this report, CBO presents the long-term budget outlook under two scenarios that embody different assumptions about future policies governing federal revenues and spending:

- The extended baseline scenario, which reflects the assumption that current laws generally remain unchanged; that assumption implies that lawmakers will allow changes that are scheduled under current law to occur, forgoing adjustments routinely made in the past that have boosted deficits.
- The extended alternative fiscal scenario, which incorporates the assumptions that certain policies that have been in place for a number of years will be continued and that some provisions of law that might be difficult to sustain for a long period will be modified, thus maintaining what some analysts might consider "current policies," as opposed to current laws.[2]

Those scenarios span a wide range of possible policy choices, and neither represents a prediction by CBO of what policies will be in effect during the next several decades. Because budget projections of this type are inherently uncertain and become more so as they extend farther into the future, the report focuses on the next 25 years rather than a longer horizon.[3]

THE EXTENDED BASELINE SCENARIO

Under the extended baseline scenario, debt would decline slowly from its high current levels relative to GDP.

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[1] The major health care programs consist of Medicare, Medicaid, the Children's Health Insurance Program, and health insurance subsidies that will be provided through the exchanges created by the Affordable Care Act, which comprises the Patient Protection and Affordable Care Act (Public Law 111-148) and the health care provisions of the Health Care and Education Reconciliation Act of 2010 (P.L. 111-152).

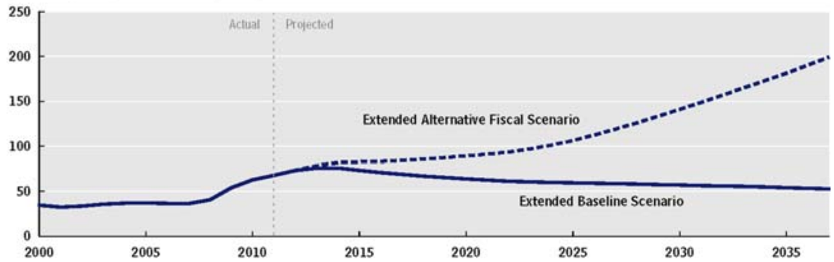
[2] The two scenarios are extensions of CBO's 10-year projections, as reported in Congressional Budget Office, Updated Budget Projections: Fiscal Years 2012 to 2022 (March 2012).

[3] Because considerable interest exists in the longer-term outlook, figures showing projections through 2087 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.

Notes: The extended baseline scenario generally adheres closely to current law, following CBO's 10-year baseline budget projections through 2022 and then extending the baseline concept for the rest of the long-term projection period. The extended alternative fiscal scenario incorporates the assumptions that certain policies that have been in place for a number of years will be continued and that some provisions of law that might be difficult to sustain for a long period will be modified.

Debt does not reflect economic effects of the policies underlying the two scenarios.

Federal debt held by the public would drift downward from an estimated 73 percent of GDP this year to 61 percent by 2022 and 53 percent by 2037 (see Figure 1). That outcome would be the result of two key sets of policy assumptions:

• Under current law, revenues would rise steadily relative to GDP because of the scheduled expiration of cuts in individual income taxes enacted since 2001 and most recently extended in 2010; the growing reach of the alternative minimum tax (AMT); the tax provisions of the Affordable Care Act; the way in which the tax system interacts with economic growth; demographic trends; and other factors. Revenues would reach 24 percent of GDP by 2037—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 health care programs, Social Security, and interest—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 more than offset the rise in spending on health care programs and Social Security.

THE EXTENDED ALTERNATIVE FISCAL SCENARIO

The budget outlook is much bleaker under the extended alternative fiscal scenario because of the changes in law that are assumed to take place. The changes under this scenario would result in much lower revenues and higher outlays than would occur under the extended baseline scenario. In particular:

• Almost all expiring tax provisions are assumed to be extended through 2022. Specifically, for this scenario, CBO assumed that the cuts in individual income taxes enacted since 2001 and most recently extended in 2010, which are now scheduled to expire at the end of calendar year 2012, would be extended; relief from the AMT for many taxpayers, which expired at the end of 2011, would be extended; the 2012 parameters of the estate tax (adjusted for inflation) would continue to apply, preventing increases in rates and in the share of assets that is taxable; and all other expiring tax provisions (with the exception of the current reduction in the payroll tax rate for Social Security) would be extended.

• After 2022, revenues under this scenario are assumed to remain at their 2022 level of 18.5 percent of GDP, just above the average of the past 40 years.

• This scenario also incorporates assumptions that through 2022, lawmakers will act to prevent Medicare's payment rates for physicians from declining; that after 2022, lawmakers will not allow various restraints on the growth of Medicare costs and health insurance subsidies to exert their full effect; that the automatic reductions in spending required by the Budget Control Act will not occur (although the original caps on discretionary appropriations in that law are assumed to remain in place); and that, as a percentage of GDP, federal spending for activities other than Social Security, the major health care programs, and interest payments will return to its average level during the past two decades (rather than fall significantly below that level, as it does under the extended baseline scenario).

Under those policies, federal debt would grow rapidly from its already high level, exceeding 90 percent of GDP in 2022. 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 2026, and it would approach 200 percent in 2037.

Many budget analysts believe that the extended alternative fiscal scenario is more representative of the fiscal policies that are now (or have recently been) in effect than is the extended baseline scenario. The explosive path of federal debt under the alternative scenario underscores the need for large and timely policy changes to put the federal government on a sustainable fiscal course.

THE IMPACT OF GROWING DEFICITS AND DEBT

In fact, the projections discussed above understate the severity of the long-term budget problem under the extended alternative fiscal scenario because they do not incorporate the negative effects that additional federal debt would have on the economy. 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 the growth of incomes in the United States. Taking those effects into account, CBO estimates that gross national product (GNP) would be lower under the extended alternative fiscal scenario than it would be if debt remained at the 61 percent of GDP it would reach in 2022 under the extended baseline scenario.[4] The reduction in GNP would lie in a broad range around 4 percent in 2027 and in a broad range around 13 percent in 2037. (Under the extended baseline scenario, GNP would be nearly identical to what it would be if the nation's debt burden remained constant.)

Rising levels of debt would have other negative consequences beyond those estimated effects on output:

- Greater debt would result in higher interest payments on that debt, which would eventually require higher taxes, a reduction in government benefits and services, or some combination of the two.
- 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.

The aging of the U.S. population and the rising costs for health care mean that the combination of budget policies that worked in the past cannot be maintained in the future. To keep deficits and debt from climbing to unsustainable levels, as they will if the set of current policies is continued, policymakers will need to increase revenues substantially above historical levels as a percentage of GDP, decrease spending significantly from projected levels, or adopt some combination of those two approaches. In fact, the current laws that underlie CBO's baseline projections provide for significant changes of those kinds in coming years. As projected under the extended baseline scenario, revenues would reach the historically high level of 24 percent of GDP in 2037, and spending for programs other than the major health care programs and Social Security would reach the lowest level relative to GDP since before World War II. Of course, many other approaches to constraining future deficits are possible as well.

Policymakers face difficult trade-offs in deciding how quickly to implement policies to reduce budget deficits. On the one hand, cutting spending or increasing taxes slowly would lead to a greater accumulation of government debt and might raise doubts about whether longer-term deficit reduction would ultimately take effect. On the other hand, abruptly implementing spending cuts or tax increases would give families, businesses, and state and local governments little time to plan and adjust,

[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.

and would require more sacrifices sooner from current older workers and retirees for the benefit of younger workers and future generations. In addition, immediate spending cuts or tax increases would represent an added drag on the weak economic expansion.[5]

Chairman RYAN. Thank you. Okay, so first, I think it is very constructive that we have what we call an alternative fiscal scenario because that sort of more reflects current policies, but just to get it clear when we talk about current law base line, the extended base line, that assumes a 30 percent cut to doctors starts January. The discretionary caps stay in place and the sequesters enacted on top of that and a $4.4 trillion tax increase occurs in January as well.

Mr. ELMENDORF. It includes the expiration of all the programs that expire under current law, and the imposition of all the new things that will happen under the law

Chairman RYAN. So, it is not very realistic, so it is very helpful to have this AFS, the Alternative Fiscal Scenario, and as we look at this Alternative Fiscal Scenario on your Table 2.1 and Figure 2.1, when we are doing real GNP per person, and long term budgetary analysis and real GNP and GDP. You have a range of estimates, and I am very intrigued with this range of estimates. First of all, on one of them over on your GNP per person, that is what basically measure standard of living, you know.

Mr. ELMENDORF. Yes.

Chairman RYAN. How much does the economy grow per person in the future, and what is great about our nation is we have always had an increase in standard of living. We have always, always given the next generation a better standard of living, better growth. I am looking at your lower estimate, which shows in the 2030s, that goes away, and down in your footnote, and we have looked at your models on this before, you said we would reach 250 percent of GDP by 2035. Under these assumptions, CBO's model cannot reliably estimate output after debt reaches that amount in the agency's judgment, which means the model cannot measure the economy going on beyond that point. Was it not at 200 percent of GDP in your assumptions a year ago? Where is the difference? Because if I recall when we had these conversations with your predecessor and with yourself, I know this is not a technical thing, but I am just curious, where do you lose competence in measuring the economy going forward once debt reaches these kinds of levels, and did you not move that out to 250 from 200?

Mr. ELMENDORF. No, sir, we did not change that, Mr. Chairman. If you will look in last year's Long-Term Budget Outlook, we show the effects of, again, the alternative scenario on GNP out at that point to 2035, and in 2035, we thought that including the dynamic effects of rising debt on the economy, and thus on the budget the debt would be 250 percent of GDP, and we show that on page 32 of last year's report. There is no magic point at which the model stops working.

Chairman RYAN. It just loses credibility after a certain point.

[5] For discussion of the trade-offs policymakers face in deciding how quickly to implement policies to reduce budget deficits, see Congressional Budget Office, Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013 (May 2012).

Mr. ELMENDORF. Right, so estimated based on historical experience, and at some point, our debt, under these scenarios, would move so far out of historical experience that we do not trust the model to be reliable. It is also true that in various parts in the reports we just cut off the vertical axis, we cut off the picture at 200 to 250 percent of poverty, because we do not think it conveys usable information.

Chairman RYAN. 250 percent of GDP you mean.

Mr. ELMENDORF. Of GDP, I mean. I am sorry, GDP.

Chairman RYAN. Right.

Mr. ELMENDORF. We do not think it conveys useful information to you, even if we can in a sense run the calculator with a route.

Chairman RYAN. So what that means is, in the 2030s, we do not think we can measure the economy going forward because the debt burdens. With any degree of confidence.

Mr. ELMENDORF. By the end of the 2030s, yes, beyond the middle of the 2030s, that is right, Mr. Chairman.

Chairman RYAN. Okay, now then let me ask you about interest rates. You know, first of all, our 10 year, you know, the yield curve is incredible these days, and part of that, I think, people would say, is because we are sort of the port in the storm, we are the safe haven. I think the 10 year note went down as much as 1.5. You predict interest rate increases, but those long-term rates are still under the past trends. What happens if rates do not stay as low as you are projecting? What is the kind of rule of thumb you have used on a rolling average of, say, a 10 year basis if rates do not stay as low as you are predicting? That is one of my biggest fears is: interest rates rise whenever, medium, long-term, above trend like they did in the 1980s, or even at the 1990s levels, and what does that do to us? And how does that move those dates up?

Mr. ELMENDORF. So, at the end of the first chapter of the report, we talk about a collection of risks that surround these projections, and you should take that uncertainty very seriously. And one source of risk we point to, as the chairman is mentioning, is the risk of much higher interest rates; it is also possible rates would be lower than we project. We note here that if interest rates under this extended alternative fiscal scenario, net interest would be 27 percent of all federal outlays by 2037 in our projections here. But if interest rates were even half a percentage point higher on a sustained basis, then the debt service costs would be even higher. So, for example, we think that federal debt would be 215 percent of GDP in 2037, not the 199 percent of GDP that we showed given the interest rate path we have assumed.

Chairman RYAN. Now, I was intrigued also with your comments on marginal tax rates. You are saying that the higher marginal tax rates go, the less output in economic growth we get. So is a good combination of fiscal policies, in your judgment, based upon what we are seeing here, lower debt levels which increases output and keeping marginal tax rates low? If they are not a trade-off, and meaning if we get savings which reduces the debt from entitlement reforms and other reforms, and better economic growth is that not the virtuous cycle we want to get on? And I am not asking you to give me a policy judgment, but I am asking you: in your judgment, do we get better economic growth for the lower tax rates and lower debt levels?

Mr. ELMENDORF. Yes, so all else equal lower tax rates mean more economic output. All else equal lower debt means lower economic output. Whether all else is equal, of course, depends on the combination of policies that Congress would adopt. The alternative fiscal scenario has lower tax rates than the baseline, but much more debt.

Chairman RYAN. But much more debt.

Mr. ELMENDORF. By our estimates, the much more debt is a stronger negative force than the lower tax rates are a positive force.

Chairman RYAN. Yeah, and that is basically the essence of our approach, which is keep the tax rates low to maximize economic growth, but deal with the spending drivers of our debt, because as we can see here, even under the AFS, you know, revenues go up. It says that spending goes up at such an incredible clip because, as you mentioned, demographics, health inflation, and the rest, if we can get that under control, then we can grow. So if we keep our debt levels at or below where we are over the long term and keep our tax rates at or below where we are, we will avoid this kind of projection that you are showing us in these various scenarios in the 2030, where debt gets so high that you cannot track growth going forward. Dodge this austerity bullet if those we get those two combination of policies in place, is that not an accurate takeaway?

Mr. ELMENDORF. So, I agreed with you up to the point about dodging the austerity bullet, I think it depends whether you [inaudible] to get there.

Chairman RYAN. I guess we defined austerity, right.

Mr. ELMENDORF. But yes, you are right that if that stays at or falls lower as a share of GDP and tax rates are lower, that combination would be the best combination of those two features of the budget for growth in the long run.

Chairman RYAN. Okay, let me get one more question on the fiscal cliff. How much do you disaggregate between the recession that you are projecting, which I believe you are projecting at a two quarter drop in output, if the quote, unquote fiscal cliff occurs. How much of that, in your judgment, results from the tax side of that fiscal cliff versus other parts of the cliff, the spending issues?

Mr. ELMENDORF. Well, a larger share of the tightening of fiscal policy between this year and next comes on the revenue side. Now, the effects of specific changes in revenues in spending will not be exactly the same on the economy in the short run.

Chairman RYAN. Right.

Mr. ELMENDORF. But altogether we think that the revenue increases with a larger factor in restraining economic growth and employment in the beginning of next year.

Chairman RYAN. Okay. Thank you, Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. Let me just pick up first where the chairman left off with some of his hypotheticals, because he asked you if you were able to keep tax rates low given everything else being equal, what would be the result, assuming also that debt remained low. But Dr. Elmendorf as you said in your testimony, all this involves very difficult trade-offs, so to the extent that we keep that low and we reduce revenue, that means that we have to cut much more deeply into other areas, is that right?

Mr. ELMENDORF. Yes.

Mr. VAN HOLLEN. And, given the fact that health care costs are increasing rapidly, especially Medicare, it would mean that we would have to come up with another way of dealing with Medicare costs, is that right?

Mr. ELMENDORF. Yes, that is right.

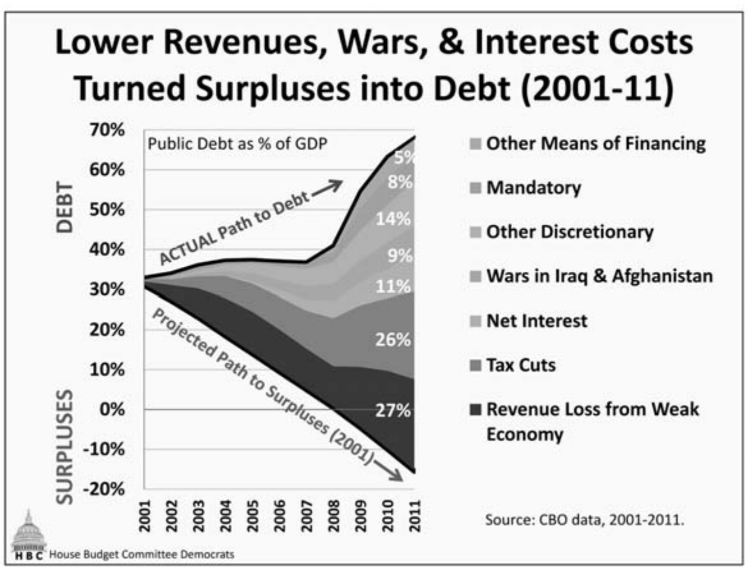
Mr. VAN HOLLEN. Okay. And, you know, just to go back to the CBO analysis of the House Republican plan with respect to creating a Medicare voucher, premium support, whatever you want to call it; my recollection is that the CBO analysis showed that it really just shifted a lot of the rising health care costs off the Medicare program and on to seniors, is that not right?

Mr. ELMENDORF. In the analysis we did a year ago of the plan that the chairman preferred at the time, we did try to offer some rough estimates of the shift of costs to beneficiaries. But in this year we were not able to do that kind of analysis; the plan was different and more complicated and we have not been able to do that comparable analysis this year.

Mr. VAN HOLLEN. That is right, and I think in the chairman's plan, he changed some of the things, which may have somewhat softened the impact, but my understanding and reading of the CBO analysis last time is the same dynamics are at play, and while it may somewhat reduce the amount of reduce the amount of risk and cost shift to seniors, it does not eliminate that problem. Have you had the chance to look at that?

Mr. ELMENDORF. We have not been able to analyze that plan.

Mr. VAN HOLLEN. Okay. If I could just put up a chart, because I think it is important as we discuss the deficit challenge that we have an idea of what components are driving it.



And what you see here is this is the debt as a percentage of GDP, and what you see is beginning in 2001, you have that black bottom line going down very steeply. That was CBO's projection of surpluses at the time; in fact about $5.6 trillion in projected surpluses. We know that by the end of 2011, we had one of the worst reversals in fiscal fortunes we had ever seen, and you see the debt rising as a percent of GDP.

And what this chart shows is the different components of it based off of the CBO numbers. The deep red being the result of the recession, the economic downturn; the pink being the result of the 2001, 2003 tax cuts. And Dr. Elmendorf, I am going to have to ask you and your colleagues to take a look at this just to confirm that this breakdown is accurate, but what it shows is I think a very simple lesson, which is that in order to get ourselves out of this long-term fiscal challenge, we not only need to deal with the spending side of the equation, but as your testimony makes clear, we should also deal with the revenue piece. When is the last time we actually had a balanced budget?

Mr. ELMENDORF. I think that was 2000.

Mr. VAN HOLLEN. 2000. And do you remember what revenues were as a percentage of GDP in the year 2000?

Mr. ELMENDORF. 20.6 percent.

Mr. VAN HOLLEN. And what are revenues as a percentage of GDP today?

Mr. ELMENDORF. There are a little under 16 percent.

Mr. VAN HOLLEN. Right, so almost a five percentage point GDP swing, is that right?

Mr. ELMENDORF. Yes, that is right.

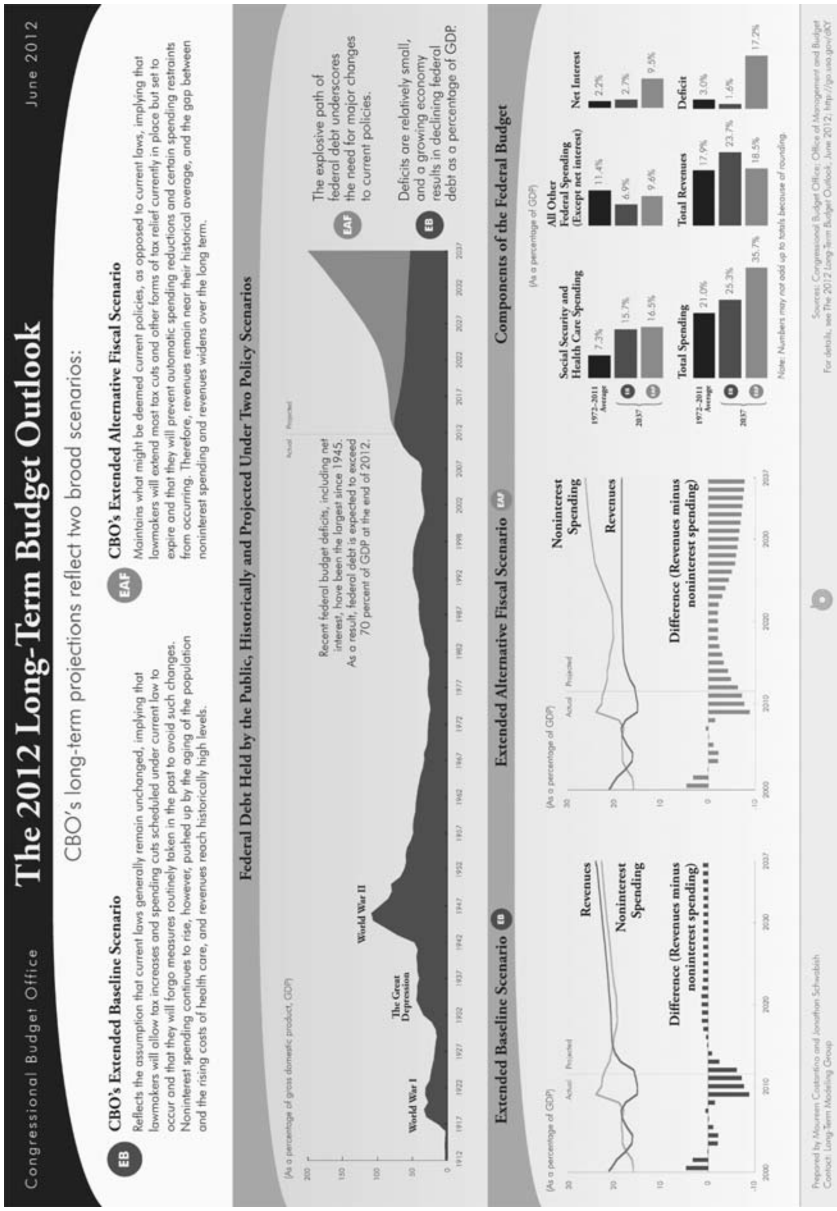
Mr. VAN HOLLEN. Okay. So, again, I want to get back to fact we in the Democratic alternative budget proposed a balanced approach that combines needed cuts, and I would remind my colleagues that as part of the Budget Control Act, we cut a trillion dollars over the next 10 years, but our proposal also deals with the revenue side of the equation, because if we do not get our fiscal house in order, as Dr. Elmendorf said in the out years, you do have this crowding out effect, which slows down the economy. In fact, Dr. Elmendorf, as you pointed out, the alternative fiscal scenario has lower revenue, correct? Excuse me.

Mr. ELMENDORF. Much lower under the extended baseline.

Mr. VAN HOLLEN. Under the extended baseline. And yet you are projecting both higher deficits and slower economic growth, is that right?

Mr. ELMENDORF. Yes, that is right.

Mr. VAN HOLLEN. Okay. If we could just go to this chart, which is something CBO handed out, I think it should be in everybody's packet.



It is in your one-pager. Because it points out the different components that make up the difference between your extended baseline scenario and the extended alternative fiscal scenario. And what I found interesting in this is that in this comparison that you did, there is actually very little difference in the major drivers of spending, in other words, if you look at Social Security and health care spending under scenario one and scenario two, it is only .7 percentage of GDP difference. In the year 2037, even when you go way out there, is that right?

Mr. ELMENDORF. Yes, that is right.

Mr. VAN HOLLEN. Okay. And if you look at the all other federal spending, as I understand it, one of the big components of that is that you assume we will not allow the sequester to go into effect, nor will we replace the sequester with an equivalent amount of deficit reduction, am I correct about your assumption there?

Mr. ELMENDORF. Yes, that is right.

Mr. VAN HOLLEN. So, if you actually look at these drivers, that component, assuming that we will not replace the sequester and the gap in total revenues, plus the interest payments, which result mostly, in this analysis, from increased debt as a result of less revenue, are the major reasons for the difference between your extended alternative scenario and the extended baseline scenario, is that correct?

Mr. ELMENDORF. I think that is right, congressman. Once the debt starts to grow relative to GDP, it continues on that path, then interest payments start to pick up in the same way, and it snowballs in a very damaging way for the economy.

Mr. VAN HOLLEN. Right. And in this chart, the major difference, I mean, the number one driver, the top driver here is the difference in revenues, correct?

Mr. ELMENDORF. Yes, absolutely.

Mr. VAN HOLLEN. And so, I want to make it clear, not proposing that we adopt the revenue policies underlined the extended baseline scenario, but I do think this chart as well as the one I put up on the screen argue very strongly for taking the kind of balanced approach that has been recommended by groups like Simpson-Bowles, bipartisan groups. Let me just ask you a question about the debt ceiling, which by most forecasts we will hit possibly at the end of this year. What would be the economic consequences if the United States did not raise the debt ceiling?

Mr. ELMENDORF. We think that a default on American debt would be a devastating blow to the economy and the financial system. It is hard to know, we have not done it, so we cannot look to historical parallels in this country, really, in the modern era, but if the default were to occur in a sustained way, if the obligations that we have taken on really were not honored that would be a shock to a financial system that is already, in this country, and particularly overseas, in a fragile state, and I do not know anybody who thinks we ought to let that happen. I realize there are disagreements among members of Congress about what else if anything should go along with increasing the debt ceiling; I do not know anyone who thinks that it would be useful to actually go and default on that debt.

Mr. VAN HOLLEN. No, I think that is right, but I do think it is grossly irresponsible for anybody to threaten that the United States will not meet its obligations unless we enact somebody else's version of how to best reduce the budget. For example, the Speaker has said that he would object to raising the debt ceiling unless we reduced the deficit the way the Speaker wants to do it. If I could just ask you Dr. Elmendorf, have you had a chance to look at the House Republican budget?

Mr. ELMENDORF. We do not analyze budget resolutions at CBO, congressman. We have looked, because you know at the chairman's own long-term budget proposal, we released our analysis of that in March, but we have not looked at the budget resolution itself.

Mr. VAN HOLLEN. And do you know that the House Republican budget would require, even if you adopted all their provisions, which would still require approximately a $5.2 trillion increase in the debt ceiling between now and 2022?

Mr. ELMENDORF. I am not aware of that either way, congressman. We have not studied that.

Mr. VAN HOLLEN. Well, if you could just get back to us to confirm that.

Chairman RYAN. Let me just do that for you; that will go up in this country under any budget scenario by the factors we are talking about here, right now. Right, demographics, and all that.

Mr. VAN HOLLEN. I just thought it was important to point out that the Speakers made a big thing about using the debt ceiling to achieve his political purposes that the Republican budget that he supports would require a $5.2 trillion dollar increase in the debt ceiling.

Chairman RYAN. And I introduced the Speaker's comments to the record last week to just make sure his comments are accurately reflected.

VOICE. [inaudible]

Chairman RYAN. Okay, Doug, turn your mic on, or pull it closer to you; I guess the sound people are not quite capturing it.

Mr. ELMENDORF. It is on.

Chairman RYAN. Okay, yeah, a little closer to you, then.

Mr. ELMENDORF. Lean closer.

Chairman RYAN. Right up front sir. Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman, Dr. Elmendorf. Just in referring to something the ranking member mentioned about tax rates revenues as the percent of GDP. In 2007, I believe, under the current tax rates, revenues were 18.5 percent of GDP, and they are down now under the same tax rates. So my question, or point of this is that the amount of revenue as a percentage of GDP is affected not just by rates but by economic conditions.

Mr. ELMENDORF. Absolutely, congressman.

Mr. CAMPBELL. So, if we had a better economy today, we would have a larger share of revenue even under the existing tax rates?

Mr. ELMENDORF. Yes.

Mr. CAMPBELL. And 18.5 percent is fairly close to historic average since World War II, is it not?

Mr. ELMENDORF. Well, when CBO talks about the averages, we generally use the last 40 years.

Mr. CAMPBELL. Okay.

Mr. ELMENDORF. The last 40 years' revenues have been averaged 17.9 percent of GDP.

Mr. CAMPBELL. Right, so under the existing tax rates in a good economy, in 2007, we actually had a larger revenues as a share of the economy, we are actually larger than the average over the previous 40 years.

Mr. ELMENDORF. Yes, that is right.

Mr. CAMPBELL. Thank you. Next question, relative to what we charitably call Obamacare, and on the other side they call it the Affordable Care Act, all of your scenarios, both the alternative scenario and the baseline scenario, include Obamacare and that law being in effect, is that correct?

Mr. ELMENDORF. So, we used the term Affordable Care Act ourselves, congressman.

Mr. CAMPBELL. I am sure you do.

Mr. ELMENDORF. But I think a lot of the independent analysts do. Under both of the scenarios, most of the Affordable Care Act is included. There is one point a little different in the extended alternative fiscal scenario; we turn off a couple of the provisions that would reduce the growth of health care spending in what was the second decade when the Affordable Care Act was enacted. In particular, we do not allow the continued reductions and the growth of payments to Medicare providers to go on, and we turn off some of the extra indexing of the thresholds for different size subsidies through the insurance exchanges. So we take away a few of the features that would create greater slowdown in federal costs in the second decade.

Mr. CAMPBELL. Why did you turn those off in your alternative scenario?

Mr. ELMENDORF. So, as we defined the scenario, we view it as extending some policies that have been in place for a long time, but also as modifying some policies that we would think would be difficult to sustain for a long period of time, and the cutbacks in payments to Medicare providers are sort of incremental; every year is a lower growth rate. And as the years go on, we think it becomes harder and harder.

Mr. CAMPBELL. So you basically think that they kind of would not work, so you take it back.

Mr. ELMENDORF. We think it would be more difficult, and we are trying to offer you an alternative perspective.

Mr. CAMPBELL. Okay. And then under either of these scenarios, then, total outlays of the health programs, Medicare, Medicaid and the S-Chip Program would rise 78 percent I have under the baseline scenario, and 93 percent over the next 25 years as a share of GDP. So the medical entitlements would rise by 78 percent as a percentage of GDP under the baseline, and 93 percent under the alternative scenario. Those figures sound correct?

Mr. ELMENDORF. Yes, they sound right.

Mr. CAMPBELL. Those are the biggest drivers of expense increases in the budget by far, are they not?

Mr. ELMENDORF. Yes, absolutely.

Mr. CAMPBELL. Okay, and then in a letter to Chairman Ryan, CBO was asked, What tax increases would be necessary if you are going to pay for all this entirely with tax increases? And you concluded that you would need 33 percent across the board rate hike by 2023, 48 percent by 2030, and an 86 percent increase in all tax rates by 2050 in order to just keep them a balanced budged under the alternative

fiscal scenario going out.

Mr. ELMENDORF. So you quote those numbers correctly, congressman. I want to be clear what the experiment was; the experiment we were asked to look at was a case where the increase in tax revenue came entirely through increases in tax rates.

Mr. CAMPBELL. Right, no.

Mr. ELMENDORF. Of course, a full other approach that was involved broadening the tax base, that of course is being discussed.

Mr. CAMPBELL. No, I understand; I have lots more to say but only 25 seconds to say it, so all I merely wanted to point out from this is that you have these huge medical entitlement cost drivers, and you cannot do an 86 percent increase in taxes; we have to deal with these things, and we have to deal with them quickly. We do not want to have the rapid changes that Europe did. Europe's problems are because they let their European socialism that they were not paying for go on too long so that they had to try and fix it too quickly. We need to get on this right away, so we have a slower glide path to correcting these problems. Thank you.

Chairman RYAN. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman, and thank you Dr. Elmendorf. As I read page four of your summary, and just paraphrasing it: To keep deficits and debt from climbing to unsustainable levels, policymakers will need to increase revenues substantially, decrease spending significantly, or adopt some combination of these two approaches, and that is basically what your testimony has been this morning.

Mr. ELMENDORF. Yes, exactly, congressman.

Mr. DOGGETT. And thus far, the Congress over the last year has pursued the reducing spending significantly only. I believe under the agreement that was reached last year, if fully implemented, spending would be reduced by about $2 trillion, is that right?

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

Mr. DOGGETT. No revenue increase at all, an entirely one-sided approach to addressing this problem?

Mr. ELMENDORF. The Budget Control Act focused on spending cuts, exactly.

Mr. DOGGETT. And your testimony this morning is if we continue to pursue that course of only cutting spending with no additional revenues, we will have to substantially reduce Medicare and Social Security, will we not?

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

Mr. DOGGETT. And each time that the Congress passes another tax cut without paying for any of it, $46 billion in a recent week for a business tax cut, $29 billion this week for a medical device tax directed mostly at trying to weaken the Affordable Health Care Act, but still $29 billion a year tends to add up. Each time they pass one of these tax cuts without paying for it, that adds to the debt, and would increase the amount of spending that would have to be cut, directly impacting Medicare and Social Security, does it not?

Mr. ELMENDORF. Yes. Any increase in spending or reduction in taxes that is not offset, that is not paid for if you some other policy changed, is going to push our debt above this trajectory we have under current law. And as I said, under current law that only very gradually declines relative to GDP, and even a quarter century from now would be exceptionally large by US historical standards.

Mr. DOGGETT. And your testimony this morning is that if we extend the Bush tax cuts and make the adjustments with the AMT associated with those and do not pay for them, that is $4.5 trillion in additional debt.

Mr. ELMENDORF. Yes, plus the debt service.

Mr. DOGGETT. Plus the debt service, which will add a significant amount.

Mr. ELMENDORF. Yes.

Mr. DOGGETT. So, though Congress has taken an approach of cutting spending by $2 trillion, one of the alternatives being advanced for approval in the House this summer, is that we have unpaid for $4.5 trillion of less revenue. And the impact will be to significantly increase the debt if that were to become law, and to make it nearly certain that we would have to make substantial cuts in Social Security and Medicare unless we wanted to have uncontrollable debt.

Mr. ELMENDORF. If those tax cuts were extended and no others were made to fiscal policy, that would make the federal budget outlook significantly worse, in the medium run and long run, and it would worse the economic outlook in the medium run and long run.

Mr. DOGGETT. Yes. My concern is that those who can continue to preach what may be a good rhetoric at a political convention that Washington does not have a tax problem and only has a spending problem ignores the fact that we really have a little of both, and that unless we have a balanced approach to trying to get our budget in balance, we ensure that Medicare and Social Security as generations of Americans have known them will not be there for them, and that is, I think, a terrible and unjustified cost to pay. As far as the spending side, because we do have to focus on both, you have talked about the fact that we do not just have a Medicare health problem or a veteran's health problem, or a children's health insurance health cost problem, we have a health cost problem generally. And one of those areas that some folks suggested might help us resolve that is to copy the federal employees' health benefit program. From looking at that program, has it produced substantial savings that would help us avoid these problems?

Mr. ELMENDORF. CBO has written about this before, congressman, I am not completely familiar with it, but I believe our conclusion was that premium increases in federal employees' program had been roughly comparable to increases elsewhere in the health system.

Mr. DOGGETT. Exactly.

Mr. ELMENDORF. And we show in our long term outlook rates, comparative rates of cost growth, Medicare , Medicaid and then the rest of the health care system for different periods of time when certain pieces have outpaced other pieces. But, we see in general as you commented across the board increases in health care costs that have outpaced the growth in GDP, and that is what creates this increasing bind for the federal budget and for state local government budgets and for the budgets of firms and households.

Mr. DOGGETT. Thank you. And just, finally, the experience then with the federal health programs shows it is no panacea to solve this rising health care cost.

Chairman RYAN. Thank you. The time for the gentleman has expired. Dr. Price.

Mr. PRICE. Thank you Mr. Chairman and welcome again, Dr. Elmendorf. The committee appreciates the long term projections that you have made. I want to talk about a couple different items. First, the debt ceiling. Our friends on the other side oftentimes use the language that people are threatening to have the United States not meet its obligations, you are not aware of anybody that is threatening to have the United States not meet its obligations are you?

Mr. ELMENDORF. As you know, I try not to characterize the comments of members of Congress. I said, I repeat, I do not know of anybody who think we actually should default. I recognize that this disagreement about what other policies if any should be combined with an increase of the debt ceiling.

Mr. PRICE. I think that is fair. If we are talking about the debt ceiling and if a debt ceiling increase is required, and the options are to have no spending reduction and a debt ceiling increase, or a debt ceiling increase accompanied with a spending reduction, which has a more positive effect on economic activity and output?

Mr. ELMENDORF. Well, in the short term, congressman, we think, as do most economists, that a cutback in government spending will weaken the economy, will lower output and employment. Over the longer term, if the reduction in government spending is not accompanied by other changes and thus leads to a reduction in the debt, then that would be good for the economy.

Mr. PRICE. So, a decrease in the debt, as you mentioned before, lower debt results in more economic activity, more economic output.

Mr. ELMENDORF. Yes, that is right.

Mr. PRICE. And a reduction in taxes, as you said earlier, or lower taxes, results in more economic output and more economic activity.

Mr. ELMENDORF. Well lower marginal tax rates in particular, as you know, many features of the tax code that effect the economy but the lower tax rates on the margin can help encourage additional work and saving and that is good for the economy.

Mr. PRICE. Exactly, and that is what we have attempted to include within our budgets. I want to talk about the economic variables that you used in this long term forecast and it is my understanding the average annual economic growth rate that is utilized for the next few years is 3.1 percent?

Mr. ELMENDORF. For the next five years, maybe congressman. I do not know that number.

Mr. PRICE. I think that is accurate. And in the same time frame you also forecast that the unemployment rate goes from its current rate to 5.5 percent by 2018?

Mr. ELMENDORF. Yes that is correct.

Mr. PRICE. And yet, last week your office warned that if the current law stays in place and $500 billion in tax increases go into effect in 2013 as scheduled that the United States will likely go into a recession for a period of time next year.

Mr. ELMENDORF. Yes that is right.

Mr. PRICE. And so is it safe to say that a recession would contract, decrease federal tax receipts similar to those levels that we saw in 2007, 2009?

Mr. ELMENDORF. It would certainly contract them. That was a very severe recession that brought revenues as low as they were a few years ago, we do not think they would fall as low again because we would be predicting a mild recession but it is only the direction that is the same, congressman.

Mr. PRICE. So, if the Congress does not act and the current law is realized, would you expand on your perspective on how this will impact the macro economy in terms of employment and economic growth?

Mr. ELMENDORF. Yes, we think that if the Congress allows current law to unfold throughout the end of the year and into next year, that the economy will contract in the first half of next year and will grow only slightly over next year as a whole and employment will be a good deal lower and unemployment higher than would be the case if the federal budget were not contracting in that way. As one goes later in the decade and beyond then the path of smaller deficits would be good for the economy and would strengthen outputs in incomes. That is what the extended baseline scenario shows here over time relative to the extended alternative fiscal scenario.

Mr. PRICE. So, the proposals that we have attempted to put forward which are either keeping marginal rates as they are, not increasing marginal rates on individuals and decreasing spending at the federal level, decreasing debt, the slope of the debt, would be a positive factor from an economic output, economic standpoint?

Mr. ELMENDORF. Yes, the lower tax rates and lower debt are both good for the economy in the long run.

Mr. PRICE. In my short time remaining, would you care to address the difference between tax rates, marginal rates, and revenue to the federal government? Because our friends oftentimes confuse those two or use those synonymously.

Mr. ELMENDORF. So, in simple terms, the revenue the government collects equal the tax rates times the tax base to which those rates are applied. And our current tax base, although we talk about the income tax as a lower tax on all income at the individual or corporate levels. In fact, our tax bases are a lot narrower than overall individual and overall corporate income. And thus given the set of tax rate that we had in place, we collect less revenue than we would if the bases were broader. Raising tax revenue by raising tax rates will tend to hurt the economy. Raising tax revenue by broadening the base could help or hurt the economy depending on the nature of the changes. So, some of the features, some of the special deductions in credits and so on, are bad for the economy because they distort an individual's behaviors. They encourage certain things at the expense of other things in a way that is not consistent with the market price signals, and perhaps not consistent with our social aims. On the other hand, there are features, credits and deductions and so on, that may be helpful in offsetting distortions that exist in the private markets or do help to achieve social gains. So it is very hard to make any broad statements about whether broadening the tax base would be good or bad for the economy. For particular sorts of changes, we have the modeling capacity and our colleagues on the staff of the Joint Committee on Taxation have the modeling capacity to provide estimates to you and your colleagues about the economic effects, but it is hard to make general statements about the effects of broadening the tax rates.

Mr. PRICE. Thank you, sir. Thank you. Thank you Mr. Chairman.

Chairman RYAN. Thank you. Mr. Blumenauer.

Mr. BLUMENAUER. Thank you. Doctor we appreciate your patience and coming back again and carefully trying to parse your words to be accurate and resist our efforts to use portions of them to justify our heartfelt needs and sound bite quota.

Mr. ELMENDORF. I appreciate you understanding my predicament, congressman.

Mr. BLUMENAUER. And I continue to marvel how well you do it. I loved how you used earlier the term “all things being equal.” Because this is the thrust of your analysis is to let us know what is going to happen, all things being equal. I love what you said a moment ago in terms of how do you structure the tax provisions, because there can be some that can reinforce productive activity, some can distort economic activity. That could be the case for example for lavish agricultural subsidies could it not? If these are borrowed dollars that distort the marketplace that encourage over production of something that may even have environmental damaging impacts and shortchange things like nutrition support which, like food stamps, actually helps sustain the economy. And this is one of the things the CBO has ruled as a powerful stimulant. So for example, all things being equal, if we had our agricultural subsidies refined, that might be something that could save money and improve productivity, could it not?

Mr. ELMENDORF. It might be, congressman.

Mr. BLUMENAUER. And I am not asking you to walk that plank right now, I just want you to help me with the hypothetical. Done right we could reduce the deficit, improve productivity and move forward.

Mr. ELMENDORF. Potentially so, yes congressman.

Mr. BLUMENAUER. Likewise, were we to deal meaningfully with reforming our military spending, some things like hundreds of billions of dollars maintaining a nuclear arsenal that we are not going to use, hopefully ever has less economic impact than lowering the deficit, reducing potentially taxes or investing in things like education and infrastructure. Is it not possible that getting that right could boost our economy while reducing the deficit? Is it not possible?

Mr. ELMENDORF. There are a whole variety of possible changes, congressman, and in federal programs that might be good for the economy.

Mr. BLUMENAUER. But maintaining nuclear arsenal does not have a ripple effect, does not strengthen other parts of the economy. I mean, this is more of a drag on the economy that investing in education, bridges or sewer systems, is it not?

Mr. ELMENDORF. Well, in general congressman, we think that when the federal government spends money, that in the short term there is a positive multiplier effect to other things. If the federal government pays my salary, I go buy some things at the store, which helps people.

Mr. BLUMENAUER. I understand the principles. I am not trying to trap you, I just want to put on the table that there are some things that have less of a multiplier than investing in our future. All things being equal.

Mr. ELMENDORF. So, yes, in addition to the short-term economic effects, where we talk about multipliers in particular, different sorts of government spending could represent investments in our future and others may be more for current consumption.

Mr. BLUMENAUER. And I guess that is one of the things that all things being equal, it would seem to me that if we were in fact investing, as we used to do in this country, on things like roads and bridges and transit, improving sewer and water and environmental protection, these investments actually put lots of people to work at family-wage jobs, have economic benefits and avoid costs in the future. Is that not possible? All things being equal?

Mr. ELMENDORF. Yes congressman. We have written about the economics of additional investment in transportation and water infrastructure. We have noted, for example, that according to the Federal Highway Administration, there are a large number of highway projects that would have benefits the substantially succeed their costs. They are not currently being funded and to fund all of those, all of that infrastructure investment, it would require a good deal more money from either the federal government or other sources.

Mr. BLUMENAUER. Well, thank you. And I appreciate your patience with us, and I guess that is the note that I would conclude on because there are lots of things that people on this committee in theirr heart-of-hearts could agree on, whether it is refining agricultural investment at a time when we have virtually zero interest rates that we could finance long-term investments for infrastructure, could make a huge difference in all our communities. And I hope we reach the point, maybe the fiscal cliff helps us look at this in a more comprehensive and thoughtful fashion in ways that will make a long-term difference to our communities and our economy. Thank you for your patience.

Chairman RYAN. Thank you, Mr. Flores.

Mr. FLORES. I would like to put Van Hollen's chart put back up on the screen if we can.

Okay. This chart I found to be interesting, there were two factors I think in play here that were not discussed. Number one is, in 2001 where the chart starts, we had an exogenous factor come into play and that is when the war on terror started, beginning with the attacks on 9/11. So, I think that that particular fact was conveniently left out and if you move over to 2007, well the political change that occurred, and that was when the other party assumed control of Congress in both houses and you can see the huge increases in spending that occurred, and also the impact on the economy with the changes in regulatory environment. Dr. Elmendorf, when the stimulus bill was passed, it was widely believed that unemployment would go down because of that stimulus program. But here we are three and a half years later, and we had a peak to 10 percent unemployment, we have had about 40 months of employment higher than 8 percent. The other side of the aisle is proposing to have another round of stimulus, they have changed the name to investment, and saying that is going to be the panacea to solve our deficits and to solve our debt problem that we have in this country , that you have done a great job of explaining. My question is this, can you explain in about 30 seconds or less why the stimulus did not achieve its desired outcomes and what inpact it has had on our debt and deficits?

Mr. ELMENDORF. The economy has performed a good deal worse than we expected and many forecasters expected a few years ago. In our assessment and the assessment of most economists I think, the Recovery Act created more output and more employment than would have happened without it. But the underlying weakness of the economy, not unusual in comparison to other countries that have had financial crisis-induced recessions, but unusual for us, the other underlying weakness of the economy has more than offset the efforts of fiscal policy-makers and monetary policy makers to put the economy back on a strong course.

Mr. FLORES. That takes us to the next question, and I have asked this question before, but what is more efficient in terms of causing increasing economic activity? Is it public sector spending, or private sector spending? And in other words, it is a choice between a Solyndra expenditure or a Keystone expenditure, which of those is better for the economy?

Mr. ELMENDORF. Well, we have not studied those two particular types.

Mr. FLORES. But they are the poster children, so let us talk about it.

Mr. ELMENDORF. In an economy where the constraint on output in the employment is weak demand for goods and services, which is the economy that we have been living through for the past four and a half years, then additional demand from the private sector or the government will raise output, raise employment relative to what would otherwise occur.

Mr. FLORES. And what causes that increased demand? What is it, other than that thinking that public sector spending can raise demand, I mean then you would have had a $4 trillion stimulus or a $5 trillion stimulus, but of course the impact on the economy would have been tragic because of its impact on federal deficits and debt. So, is it not better to rely on private sector spending to for economic stimulative activity. Would you not want to do things that encourage private sector investment and jobs in our economy and paychecks than public sector spending?

Mr. ELMENDORF. Well, congressman, we have been clear that the extra debt was accumulated through the Recovery Act, if not offset by other policy changes later will lead to an ongoing level of higher debt that will in the medium-term and long-term be a drag on the economy.

Mr. FLORES. Correct, so we would not want it.

Mr. ELMENDORF. I think policy makers have tried to both stimulate private spending and to increase public spending.

Mr. FLORES. So it would be inappropriate to double down in terms of a failed program to continue. If the stimulus works, the stimulus version 1.0 worked, why would stimulus version 2.0 work any better?

Mr. ELMENDORF. congressman as you understand, and I recognize you do not agree with us, but our position is that the Recovery Act was not a failed program. Our position is that it created a higher output in employment than would have occurred without it. And we did analysis last fall and testimony to the Senate Budget

Committee of a collection of alternative proposals. Some tax increases, some tax cuts, some spending increases that we think would spur output in employment.

Mr. FLORES. What would have a higher impact, if you have $700 billion of addition GDP from the private sector versus $700 billion of GDP of spending from the public sector, which would have a greater impact on the economy?

Mr. ELMENDORF. Over the past few years, congressman, that extra spending, wherever it came from, would have led to more jobs. And there is no reason to think that the extra spending on the private sector would lead to more additional jobs and extra spending in the public sector. Over a longer period time, the question is, what sorts of goods and services have been purchased? And if the public sector was investing, then that would be good, and if the private sector was investing, that would be good in the long run.

Chairman RYAN. Thank you.

Mr. FLORES. That was fascinating.

Mr. ELMENDORF. We each have our own conclusion.

Chairman RYAN. Time is getting near. I would just say to the gentlemen from Texas, we had that hearing on multiplier effects where there is clearly a difference of opinion on Keynesian multipliers and it maybe go back to that hearing. We had Mr. Zandi who I think represented the CBO's position and we had Mr. Taylor from Stanford who represented an alternative position. That hearing probably kind of gives a little illustration on this point. Ms. Bonamici.

Ms. BONAMICI. Thank you Mr. Chair. Thank you Dr. Elmendorf for your testimony. The cost of health care, as frequently mentioned, is a significant factor in increased spending and your testimony certainly reinforces that as well. And traditional approaches to addressing rising costs have included cutting people from care, cutting provider rates, cutting services. And in my state of Oregon we have come together in order to take a new approach, particularly regarding the uninsured and our Medicaid dollars. It was actually quite refreshing to see business, labor, Republicans, Democrats, educators, all come together and work on this health care transformation with a goal of improving care while costs, integrating and coordinating services, including physical and mental and oral health care.

The modeling that has taken place involves coordinating physical and behavioral health care, better preventing and managing chronic diseases, using patient-centered primary care homes and improving and aligning care for individuals who are dual-eligible. So the establishment of these coordinated care organizations is projected to actually improve care while reducing costs and increasing access, and in fact by coordinating services Oregon projects a 4.9 to 9.7 percent savings in the second year of implementation compared to without the transformation to a 10 percent increase. And this savings is expected to build over time. And I wonder if you could talk a little bit about how this type of change would impact the federal budget if a similar approach was implemented in other states as well.

Mr. ELMENDORF. Well I think, Congresswoman, there are a tremendous amount of experimentation going on in different states and different private providers of care and private insurers and in effort to get more value for our health care dollars. And I think the ferment of experimentation is a very positive factor. But it is also true that a number of experiments that have been tried over the years have not worked as well as advocates hoped, and even those that have worked have proven in some cases more difficult to expand across different provider settings, across different states health care systems. We did a long and careful review of a collection of Medicare demonstration projects in both value-based payment methods and in disease management and care coordination. And these were Medicare demonstrations, we wrote about this last year, and the set of demonstrations that Medicare has tried have found that when there is a direct interaction between a care manager and physicians and then in-person interaction with patients, where there really is a lot of effort, a lot of energy being focused on this care coordination, that that sort of model is more likely to reduce spending, gross spending, but it also had its own costs in terms for paying for these interactions. So, in Medicare, there has not yet been a model that is been used in any widespread way that has had the effects that people are looking for, of higher quality care and lower cost at the same time. It doesn't mean that it cannot happen, probably it can happen, but people are still trying to figure out just how to do it and, just how to do it, as I have said, in different sorts of settings.

Ms. BONAMICI. Right.

Mr. ELMENDORF. So, the Affordable Care Act introduces a lot of different programs, in particular the Center for Medicare and Medicaid Innovation, as you know, that is designed to do more experiments faster, to reach conclusions more rapidly and then to be able to extend the successful programs across the system more rapidly. And we think that will have some positive effects, but how large those effects will be and just what arrangements will turn out to be most effective, we do not know yet.

Ms. BONAMICI. Well, thank you for your testimony and I know that we will all be watching what is happening in my home state as well as those other states, because until we can increase access and start addressing the high costs of chronic care, we are going to be increasing those costs and we need to be keeping people out of emergency rooms. So, I appreciate your testimony and I yield back my time.

Chairman RYAN. Thank you, Mr. Lankford.

Mr. LANKFORD. Thank you. Thank you as well for being here. Let me talk a little about page 35 of your report. You have an interesting section of something I have talked a lot about as well, and that is the effect of government borrowing. And what effect that really has on the economy as a whole and just this top paragraph in the right-hand column there. "Increased government borrowing generally draws money away from or crowds out private investment and productive capital, leading to a smaller stock of capital and lower output in the long run that would otherwise be the case. Deficits generally have that effect of private investment because the portion of people's savings used to buy government securities in not available to finance private investment. The description that you made there, I have talked about before and I know you spoken about it often as well, and that is this effect that the more that we borrow the more that we require of capital that would otherwise be invested into productive things, rather than just sovereign debt. That is occurring worldwide currently. This trend as you said, I am going to ask you, that some of you want to talk about it or not, but we have got that issue happening in Europe, other parts of the world as well as here. What do you think that effect is currently of the crowding out of investment worldwide based on sovereign debt?

Mr. ELMENDORF. Well the countries in Europe have a collection of overlapping problems, as you know. They have a banking crisis, they have a fiscal crisis, they have a growth crisis. And, as we wrote in an issue brief a few years ago about the risk of a fiscal crisis in the United States, once one ends up in that situation, then there are no good options. Countries that are unable to borrow at affordable rates feel the need to cut back on their borrowing, at the same time cutting back on spending, or increase in revenues, tends to the slow economy which then worsens their budget situation, and it really is a vicious circle. We think the European economic situation is weighing on the U.S. economy now and has the potential to be a much more significant negative force if they do not find a way to keep their system going.

Mr. LANKFORD. But it also is a benefit to us in that it keeps our interest rates low because people do not invest in their sovereign debt, did invest in ours. And so, it is this double-edged sword that yes, it is slowing down our economy, but yes it is actually helping us in keeping our interest rates low on our debt.

Mr. ELMENDORF. Yes, it is pushing down treasury interest rates.

Mr. LANKFORD. Right.

Mr. ELMENDORF. Because people are engaged in this flight to relative safety. But it is probably weighing on other parts of our financial system and that is, I think, where the biggest risk lies. If they have a larger collapse in their financial system, their potential of very large negative spill over to ours.

Mr. LANKFORD. Right, you have mentioned often as well about tax rates and marginal rates and such, and that a lower marginal rate tends to increase productivity or at least activity in the economy. Can you factor in certainty and uncertainty in the last several years as well? There has been this constant “We do not know what the rate is going to be next year” mentality, that is happening. Rates seem to be tweaked out every single year. Can you factor in the difference between certainty and uncertainty and marginal rates?

Mr. ELMENDORF. It is very difficult to quantify. We think that the uncertainty about federal policies on a whole variety of areas, including the tax code, is weighing on the economy. It is a negative factor in the current economy, a whole bunch of factors, it’s very hard to know.

Mr. LANKFORD. As we walk through this year, once we get near the end of the year there is common discussion about all this expiration on all of these tax rates from 2001 and 2003. Better to resolve those earlier, or better than to resolve those later? We have got about six months to do either of those, so it is not exactly early even at this point.

Mr. ELMENDORF. Earlier is better. No doubt.

Mr. LANKFORD. Okay Do you think it is possible to address our national debt burden, our deficits at all, without dealing with the major entitlement programs?

Mr. ELMENDORF. Well, congressman, as I have said at the beginning, it is possible to maintain Social Security, Medicare, Medicaid, as they are under current law, but only by substantially raising taxes on a broad group of Americans. And similarly, it is possible to maintain taxes at their historical share of GDP, but only by making substantial cuts relative to current law in large entitlement programs that benefit a broad section of Americans at some point in their lives. That is what makes this choice that you and your colleagues face and that we as American citizens face so difficult. One can pick to hold one part of the budget as it would otherwise be, but given the gap between revenues and spending on foreign policies, then one has to make even larger, even more dramatic changes in the other part of the budget. And you can see that in our extended baseline scenario here, what happens under current law, which is a very large increase in tax revenue. And one can see an alternative vision in Chairman Ryan's long-term proposal that we analyzed in March, which holds revenues down and makes very large cuts in a number of federal programs.

Mr. LANKFORD. Either way, earlier is better to resolve this.

Mr. ELMENDORF. But certainly, for those longer term issues as well, earlier is much better because it gives people time to plan and adjust. It gives you a chance to phase in changes gradually, and yet have them take effect in a way that is important in dollar terms before the debt gets even larger than it is today.

Mr. LANKFORD. Thank you, I yield back.

Chairman RYAN. Thank you, Ms. McCollum.

Ms. MCCOLLUM. Thank you, Mr. Chair. Director Elmendorf, this is interesting, we talk about cuts in entitlement programs a lot, but, I would like to talk about another program and your assumptions on that in your two scenarios. What were your assumptions for defense spending as a percentage of GDP?

Mr. ELMENDORF. Defense spending?

Ms. MCCOLLUM. Defense spending.

Mr. ELMENDORF. So, I am, so what we do for our long term scenarios is we just take the set of all programs.

Ms. MCCOLLUM. I understand, I just have a few minutes if you could just tell me what it is.

Mr. ELMENDORF. We do not have an explicit projection for defense spending.

Mrs. MCCOLLUM. You do not, okay.

Mr. ELMENDORF. Beyond the ten-year budget window. In the window, we had a specific base-line projection.

Mrs. MCCOLLUM. And that is?

Mr. ELMENDORF. And, I, that I am not sure.

Mrs. MCCOLLUM. Well, then you would have to look for that. So, maybe you could get back to us if you cannot answer this question. Mr. Romney, who is the Republican nominee for president soon-to-be, has proposed to never allow defense spending to go below 4 percent of GDP. What would be the impact of such a sustained elevated level of spending over the remainder of the decade? And that is, you know, he just said never go below, he did not say anything, he did not put any qualifiers for global security environment. What would that have on the effect of domestic discretionary spending under your two scenarios?

Mr. ELMENDORF. Well, see in our baseline Congresswoman, this all-other category is only 7.3 percent of GDP in 2022, so if defense spending were 4 percent of GDP, that would leave to just a little over a 3 percent of GDP for all domestic programs apart from this handful of large entitlement programs. And that would be a dramatic reduction relative to their historical average.

Ms. MCCOLLUM. So, there is a plan on the table from Mr. Romney and I mentioned his decision to never allow defense spending to go below 4 percent of GDP and he also talks about cutting revenues of $6 trillion over the decade by making the Bush tax cuts permanent, cutting the corporate rate from 35 to 25 percent, eliminating the state tax, capital gains tax, taxes on dividend earnings along with other tax breaks, so when you add the increase to defense spending, what would be the impact on the deficit with all the other cuts to revenue that he is talking about having? And what effect would it have on the safety net in the entitlements?

Mr. ELMENDORF. Congresswoman, I am sorry, we have not analyzed Mr. Romney's plan, nor do we ever analyze the plans of candidates for office.

Ms. MCCOLLUM. Well, you have two scenarios.

Mr. ELMENDORF. I cannot speak to a collection of things that he particularly would do.

Ms. MCCOLLUM. Okay, but you have two scenarios. One in which you have the tax cuts not happening the sequestration happening. Mr Romney's talking about undoing that and then increasing defense spending. I mean, what would be the effect on the safety net in the entitlement program? Because you do have one scenario in which the Bush tax cuts expire, the corporate rate doesn't change. He is talking about undoing that.

Mr. ELMENDORF. Right, so if you extend all of the tax policies that are expiring, as we do in our alternative scenario, but then that by itself would put that on this steep upward trajectory. If one then wants to maintain the slight downward trajectory of that under current law, then one leads to other parts of the government by trillions of dollars.

Ms. MCCOLLUM. So, that, it would be that scenario plus more spending for defense.

Mr. ELMENDORF. And if one increased defense spending relative to what is in current law, and it is still wanted to keep dead on the downward trajectory, then one would have to make probably larger cutbacks in other domestic programs.

Mrs. MCCOLLUM. Thank you. Thank you, Mr. Chair.

Chairman RYAN. Mr. Stutzman.

Mr. STUTZMAN. Thank you Mr. Chairman, and thank you Mr. Elmendorf, Dr. Elmendorf for being here. I always enjoy your analysis and your testimony. I would like to talk about interest rates and then segue that into taxes. On page 32, one of your points under interest rates says "an increase in government debt tends to raise interest rates by leading people to allocated a larger portion of their savings to the purchase of government security, such as Treasury bonds, thereby crowding out investment in productive capital goods such as factories and computers." Does your report here touch on why our interest rate is at record low levels right now?

Mr. ELMENDORF. We do not talk about that here, congressman. We will in our August regular forecast update. The principal factors seem to be weak economy, and thus weak private credit demands and a flight to relative safety from financial markets, particularly in Europe, that are in an especially fragile state right now.

Mr. STUTZMAN. QE1, QE2, that is obviously playing a part of that. If that expires, are we going to see interest rates increasing in the near future?

Mr. ELMENDORF. Well, there are certainly for sure rates that are important, I was more focused on the longer run rates. And the actions of the Federal Reserve have brought down longer term rates. So if one looks at financial markets out beyond the next few years, out, say, later in the decade, they are expecting those to increase in interest rates, short-term and long-term interest rates, and our economic forecast has included in it those increases in short-term and long-term interest rates. Later in the decade, we are looking for a short-term rate close to 4 percent and a 10-year rate at about 5 percent, and that is roughly consistent with the readings in financial markets.

Mr. STUTZMAN. Okay, and then on page 43, under the bullet point of the need for higher taxes or less spending on government programs. Am I correct, from what you stated earlier, you talked about rates versus base, because there is a lot of rhetoric here in Washington about that Republicans are against revenue increases when, in fact, in our own budget we address the tax policy and suggest that we go to two tax rates, at 10 percent and a 25 percent tax rate. Is it clear that you are discussing one scenario versus the other, where there is a tax rate increase, which you are discouraging with the expiration of the tax rates? Or in your alternative scenario, a broadening of the base. Do you discuss any of those in the report?

Mr. ELMENDORF. No, we do not. I mean, we are not trying here to particularly explore the details of alternative tax policies. I mean, current law would have a certain set of things occur, which we try to capture in the extended baseline scenario. And then the alternative scenario tries to capture the extension of a variety of expiring provisions. So it turns out that, under this alternative scenario, given the provisions, if one extends the expiring provisions that marginal tax rates are kept low and the base does not change, really. And it also turns out that under current law, there is some effective broadening of the base because more and more income would be taxed under the alternative minimum tax, which just has a broader base than the regular individual income tax.

Mr. STUTZMAN. So broadening the base would not hurt the economy the way that raising the rates, current rates, would affect the economy, is that correct?

Mr. ELMENDORF. That is generally true, but again, the effects of broadening the base depends a lot on the nature of the broadening. And particular provisions that might be broadened in say tax reform plan that Congress considered, we would have to look at the specific provisions, and we are prepared to do that, and talk with you about that comment and the effects of those.

Mr. STUTZMAN. Okay. Thank you, Mr. Chairman, I yield back.

Chairman RYAN. Thank you, Ms. Schwartz. Oh wait, I am sorry, Ms. Castor, my apologies. Ms. Castor, you were here first.

Ms. CASTOR. Thank you, Mr. Chairman. Thank you Dr. Elmendorf for being here today. If we had more people working across America, would our debt and deficit situation be improved?

Mr. ELMENDORF. Yes, absolutely.

Ms. CASTOR. Can you tell us if the unemployment rate was 1 percent lower, how much lower our debt and deficit situation would be? Or 2 percent?

Mr. ELMENDORF. I did not bring that magic table. This is now the second time I wish I had. We wrote a letter to congressman Van Hollen a few months ago that talked about the effects on the budget if the economy were stronger. I think we said about a third of the current deficit would go away if the economy were somehow immediately put back close to full employment.

Ms. CASTOR. See, that is one of the frustrations because there is absolutely no dialogue from my friends on the other side of the aisle as job creation as part of debt reduction and deficit reduction. We could really give a boost to this improving economy if we could do some things on jobs. I mean, here are the positive signs, we have had 27 straight months of private sector job growth, manufacturing employment continues to trend upwards, consumer confidence is up, the median home price, the sales figures are up, corporate profits are up. So, things are trending in the right direction and here the Congress could be really helpful in job creation and in deficit reduction if we could come together to do some things on jobs, but unfortunately my friends on the other side of the aisle blocked a jobs plan put forth last year that said, you know, let's rebuild schools across America, that would put a lot of people in construction back to work and leave us with better facilities for students. They have stalled the transportation bill. I mean, look at this transportation bill. When do you have 75 votes out of the United States Senate on bipartisan bill, and yet that has been sold for months and months and months. And I heard your earlier comment, when it comes to infrastructure, you said oftentimes the benefits, the benefits exceed the costs, is that correct?

Mr. ELMENDORF. Yes, that is right. It depends a lot on the specific project, but there are a lot of projects that are not being done, on the highways for example, where the benefits to the economy would be a lot greater than the costs.

Ms. CASTOR. And then when you factor in the Republican budget that was passed, that is a prescription for disaster when it comes to the future plans for this country because they so slash the important investments that government and the private sector work on together, whether it is in scientific research, or it is in infrastructure, in education. And I think their one-sided unbalanced approach is really going to cause great damage. I think it is causing damage now because we could come together now to take a good whack at the debt and deficit if we could do some things on jobs. So I am hopeful, there is still time to do it, but I hear your message loud and clear, sooner rather than later. Thank you, and I yield back.

Chairman RYAN. Thank you, Ms. Black.

Ms. BLACK. Thank you, Mr. Chairman, Mr. Elmendorf I always appreciate your reports, I do read those and highlight them and learn so much by them, so thank you for your work. I was not going to go in this direction, but I just have to address what the gentlelady from Florida was talking about, that there are ways to raise revenues, one is to tax people more and the other is to have those that are employed paying those taxes, which then raises revenue. And I cannot let this go by to say to say that as I am visiting with my job creators in my community that what they tell me is that there is so much uncertainty out there, this is why they are not growing.

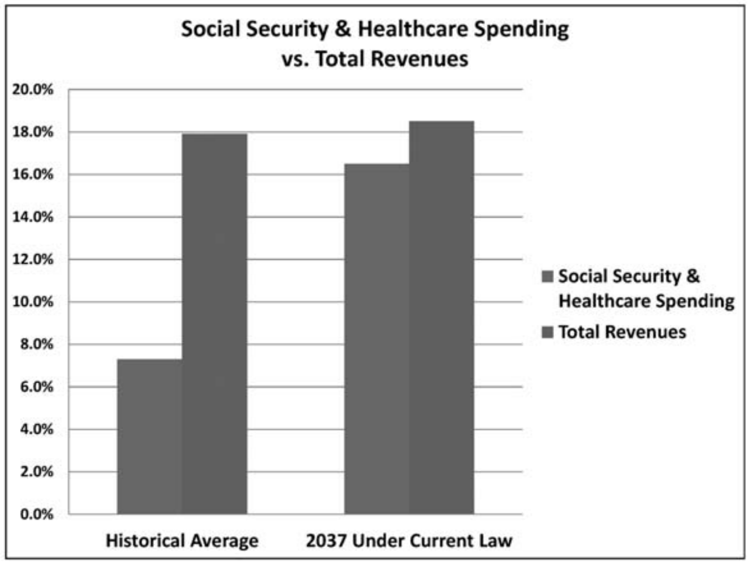
The uncertainty really creates paralysis, and certainly what you are saying on the budget outlook and helping us to understand where the debt drivers are helps us to make those decision on policies but we have got 30 pro-job creator bills laying there that have not been handled by the Senate, so let me just go to the area, though, when we look at those areas that are driving our debt and the long-term debt of our country, what would you say the significant drivers are?

Mr. ELMENDORF. Well, the feature of the budget that is becoming much different than it was in the past, it is spending on the health care programs, and in some extent, spending on Social Security because of the rising costs of health care and the aging of the population.

Ms. BLACK. So those two drivers that are most significant that we continue to hear about in the budget forecast that you give to us in other ways are Social Security, Medicare, and Medicaid. Would you say those are the biggest drivers?

Mr. ELMENDORF. Those are the big changes. What you decide to in response to those is, of course, up to you.

Ms. BLACK. If we could bring up the first chart that is taken from the CBO report but put into a chart that, I think, is easy to take a look at, we see historical average versus no changes in any of these programs, what will happen under the current law.



So we see what has been the historic level spending on these two areas. Mr. Elmendorf.

Mr. ELMENDORF. I cannot check the exact numbers.

Ms. BLACK. Okay.

Mr. ELMENDORF. But I can certainly capture the gist of the point, Congresswoman, which is that Social Security and health care spending are on track to be much larger shares of the economy than they are today and there are a larger share today than there were over the past several decades.

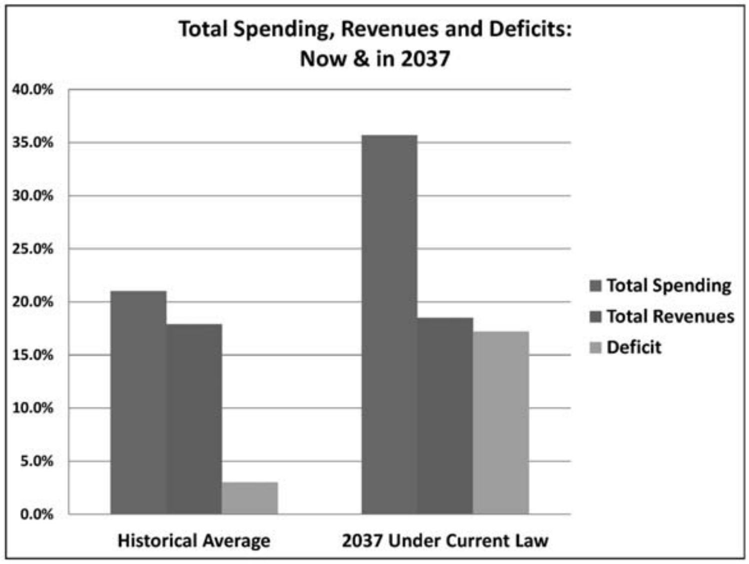
Ms. BLACK. So, if we just take a look at really these two categories, we see they represent about a quarter, about 25 percent of GDP, and then if we look at it historically and where it will go, we are going to go up to 60, so we see here our total revenues. There is not a whole lot of room left for anything else in the budget, would you agree with that?

Mr. ELMENDORF. Yes, now I should say, in that picture, I think Congresswoman the 2037 under current law, you have to set revenues just above 18 percent of GDP. So, to be clear, that is actually under our extended alternative fiscal scenario. Under current law, revenues rise a good deal more. But I think what you have done here is to extrapolate what we might think of as current policies.

Ms. BLACK. Right.

Mr. ELMENDORF. And hold revenues at that share of GDP. And certainly if revenues are held at that share of GDP, as they have been historically, then the dramatic rise in cost for other programs makes the budget completely untenable and that is why ultimately you and your colleagues face this choice of pushing that left bar down or that right bar up.

Ms. BLACK. And so, I think we just have to admit we cannot stay where we are. There have got to be policy changes so, if we could go to the next chart, and I think this is even more devastating if we look at current policy and we do not do anything, we keep sticking our head in the sand and saying, "Oh, we will just wait and wait."



We see here that by 2037, our total spending far, far outpaces our total revenues and we see how our debt continues to grow. And I think that these charts, as we put these out there for people to see rather than these reports, are so instructive and if we have time to read these, that is great, but when we just take a flash, and we take a look at these in a chart form, it has got to wake us up to say there have got to be some changes as we move forward into the future.

Mr. ELMENDORF. That is absolutely right, Congresswoman. We cannot go back to the combination of policies in the past. I am just noting about this chart, again, to be more clear, this under current law is actually under the alternative scenario. Moreover total spending is that high in large part because of an explosion of interest payments, reflecting the gap between the non-interest spending and revenues for all the years between now and 2037. Non-interest spending would itself be a good deal higher in 2037 than it has been historically, but not as much higher than our historical average is showing in this picture.

Ms. BLACK. So, I mean, you can take a lot of these scenarios and do different things with these charts, but I think that the most important thing is that when we take a look it in a chart form such as this, it has got to be just striking to us that we have go to act on this and we do have some alternatives out there and hopefully we will get serious and get out of the politics and get down to the policy and address these and get it done for the American people. Thank you very much.

Mr. ELMENDORF. Thank you Congresswoman.

Chairman RYAN. Thank you, and now we, last but not least Ms. Schwartz.

Ms. SCHWARTZ. Thank you very much. And I appreciate your testimony and your patience. Actually it was a good to follow Ms. Black. I was really interested in your answer response on her charts, because you just spent just about two hours telling us that it is not just spending, it is also revenue. And that last chart really ignores the fact that we can do something about revenue. I was surprised that you did not say that "Yes, it is not just spending," because you had just said it many times that the problem we are facing in terms of deficits and the dramatic increases in deficits and the national debt relate to both spending and reductions in revenue. That is true.

Mr. ELMENDORF. Yes, yes, the unsustainability of fiscal policy is the gap between spending and revenues, the gap under current policies and whether you choose to resolve that by raising tax revenue or cutting spending is a choice that you can make.

Ms. SCHWARTZ. And that last chart that was shown is based on the fact that they will continue to be the lower revenues built on the fact that there are as an insistence on the Republican side instead of looking at both spending and revenues and recognizing that given the economic concerns about deficit, we cannot ignore the revenue side. Now, you have pointed out how we do that is for us to decide. But whether we maintain those tax deductions for our largest corporations, whether we can afford to do that, is completely ignored by that chart. And I just wanted to have you make absolutely clear that that is a choice the Republicans are making, to only looking at the spending side and refuse to look at the revenue side. And in fact, reduced revenues, that they want to continue, they are making a choice to continue reduced revenues, refusing to raise any revenues. They have said only discussion about tax policy as if it is revenue neutral. No new revenues. Even if those tax deductions are not contributing to economic growth, even if they do not anything.

Chairman RYAN. Will the gentlelady yield?

Ms. SCHWARTZ. No. Would you answer that, I mean, would you just speak to that?

Mr. ELMENDORF. You are certainly, you are certainly right, Congresswoman, that the explosion of debt and explosion of interest payments that we show under the extended alternative scenario, could be addressed either by reductions in spending relative to that scenario or increases in revenues.

Ms. SCHWARTZ. Or a combination.

Mr. ELMENDORF. Or through a combination.

Ms. SCHWARTZ. One of the things we have put forward and I contend this all the time that budgets are bad choices. We have put forward, the Democrats have put forward, a budget that is clear about our insistence, that yes, we are going to deal with the deficit, we are going to create that certainty, we are going to do it in a way that does not hurt our fragile economic recovery. We have seen economic growth, but we want to see more. And the only way we are going to do it, and every bipartisan commission has said it has got to be both looking at the revenue side, getting rid of tax deductions that do not grow the economy, in spite of the other side saying they are job creators, they have not created jobs. Now, you know, the provisions that do not create jobs, that do not create economic growth, that we can get rid of those. That we can see something on the side of revenues. But of course we are going to cut spending, we have already, we have made that commitment. A trillion dollars this year, a trillion plus at the end of this year in tough ways. This is really about choices that we are making and it is about choices of whether we take all of it out of the spending side, that we walk away from our commitment to our seniors on Medicare, which is of course, the Republicans have voted for time and time again, that we walk away from investments in education and innovation and growth industries and yes, this was just pointed out on our side, walk away from potential of public investments now such as in transportation, infrastructure, that not only grow jobs right now but actually help economic growth in the private sector by creating demand and creating an environment that grows jobs and encourages companies to stay here, invest here, and grow jobs in the private sector. It is certainly possible and in your testimony for the past two hours have suggested we have got to take the approach for balanced approach and we have got to do it sooner than later.

Mr. ELMENDORF. As you know Congresswoman, I cannot tell you what approach you should take, but you are absolutely right that you and your colleagues and we as citizens face fundamental choices about the rule of the government in our society, what we want to do collectively versus what we want to do privately. And the choices are forced upon us because we have a set of programs that are becoming muchmore expensive than they used to be.

Ms. SCHWARTZ. And reduced revenues

Mr. ELMENDORF. Everything else has to adjust.

Chairman RYAN. Thank you. Mr. Huelskamp.

Mr. HUELSKAMP. Thank you Mr. Chairman. Doctor, I appreciate you being here. I had a couple follow up questions on earlier discussion and I think from one of my colleagues in reference to the stimulus package and why it did not work and you had some comments, but I want to refresh your memory. The administration, and I presume the CBO, had predicted the same outcome, or similar outcome, predicted that the unemployment rate today would be 5.7 percent. If that had worked as the economists, or most economists I guess in town, that were promoting that, of course today it is 8.2 percent is the actual unemployment rate. The delta of the difference is 13 million Americans are not working today . You said that the economic recession was worse than was figured. Well, can you tell me what numbers were missed? The reason I am asking this, this is not a gotcha question, I am trying to find out who in this town actually does an accurate job of predicting, because the folks that said we need to spend more money were very, very wrong. And can you tell me where you and others were wrong as far as the economic figures you were using for that type of projection?

Mr. ELMENDORF. Yes, congressman. Those are good questions. Economic forecasting is very hard. We release a regular update of our success at that, and I think a good way to summarize that is that we are no worse than other economic forecasters. But to put it that way deliberately it is very hard to do. I think in our case and for many people, for many forecasters, the U.S. has not experienced a recession of the magnitude of the one we have just lived through since the Depression. We have become used to having infrequent and fairly mild recessions, and we and other forecasters expected this to be like that. In fact, people who had studied more carefully downturns of other countries following financial crises were saying from the beginning that in this sort of situation we should be looking for a much longer and more pronounced downturn in this country. And they turned out to have been right. I want to be clear about the effects of the Recovery Act. There is disagreement, as the chairman noted, among economists about the size of these multipliers. And reflecting that disagreement, we show ranges of estimates. But there is only a small fraction of the profession so that the Recovery Act was not good for the economy.

Mr. HUELSKAMP. And doctor, I appreciate that. But what particular figures, just in general, you are saying that most economists were generally wrong, or were there specific indicators that were missed? And this gets pretty political because we have folks suggesting, and maybe yourself, that it was not big enough, that we should be spending more money. And actually according to your report on page 34, you suggest that if we could just spend some more money somehow that is going grow the economy some more. And after spending $880 billion with a $1.1 trillion cost to pay it back, I just cannot figure out what economic indicators were missed to suggest that we should have another stimulus to this, or a bigger stimulus to this, or just spend more money of any type and somehow that is going to grow the economy. What did you and other economists miss, specifically, that led to this huge jobs deficit between what was projected by the folks that produced the stimulus? I mean we are talking 13 million Americans would like an answer to say, "Okay, where did Washington mess up?" because you say most economists think it should have worked. It did not.

Chairman RYAN. Can you, can the gentleman yield for a second? So, yes, sir. So the question is, if I am mistaken Doug, whether the multiplier is above one or below one, and that is where very, very few people say it is below one. Is that not the case? And then, what was the Bernstein multiplier?

Mr. ELMENDORF. The question of whether the Recovery Act was good for the economy is the question whether the multiplier is above or below zero.

Chairman RYAN. Zero, yeah, excuse me. Zero.

Mr. ELMENDORF. And so, can I just put into the transcript on this regard, there was a question of economists at the University of Chicago that do a regular survey of distinguished economists of leading universities on issues of public policy to show where the agreements lie.

Chairman RYAN. Whether a dollars of spending produces more than a dollar's worth of economic output, or less. Right? That is basically the question here?

Mr. ELMENDORF. So, I will read you the specific question they asked: Because of the American Recovery and Reinvestment Act in 2009, the U.S. unemployment rate was lower at the end of 2010 than it would have been without the stimulus bill. Can I answer that question?

Chairman RYAN. Oh, sorry, I thought you did.

Mr. ELMENDORF. That was the question, with a question mark at the end. They phrased it as a statement, I am just quoting it directly. "Because of the Recovery Act, the unemployment rate was lower at the end of 2010 than it would have been without of the stimulus bill. 80 percent of the respondents agreed or strongly agreed with that statement.

Chairman RYAN. Right.

Mr. ELMENDORF. Only 4 percent disagreed or strongly disagreed.

Chairman RYAN. Right, meaning positive number versus negative number. 80 percent.

Mr. ELMENDORF. And I am not sure if John Taylor is in this group, if he were, I would presume he would be in the 4 percent. But that is a distinct minority.

Chairman RYAN. Right. So here's what I think he is getting at.

Mr. ELMENDORF. Consistent with the consensus in the profession.

Chairman RYAN. What was the multiplier, I think it was the Bernstein, Romer, I cannot recall who came up with the multiplier to generate those stimulus projections. What was that multiplier they used to generate those projections? Was it 2.-something, was it not?

Mr. ELMENDORF. I do not know what they did.

Chairman RYAN. No, I know, what he is getting at is, how did they get it so wrong off their projections, and my question is what was the multiplier that they used and was that multiplier not outside of the realm of what most economists thought it would have been.

Mr. ELMENDORF. So, I just do not know what they used. I know what we did. We went through the literature, we look at a set of multipliers from the evidence the economists generated. We reported what those multipliers are.

Chairman RYAN. And yours was 1.-something, right?

Mr. ELMENDORF. Well, for every sort of provision, every multiplier is different. I mean, we have talked about the differences. I think for the Recovery Act as a whole, and of course a part of the Recovery Act was tax cuts.

Chairman RYAN. Right.

Mr. ELMENDORF. It was not all spending increases, I think in the end we thought the multiplier on average across those provisions was about one.

Chairman RYAN. Right.

Mr. ELMENDORF. In very rough terms. And that is what we have been reporting in our regular reports.

Chairman RYAN. And his point, I am doing this off the top of my head, if I am not mistaken, it was that the Bernstein Romer multiplier, I think it was Bernstein. That was 2-something, was it not? Joyce, do you know the answer to that? No.

Mr. ELMENDORF. It may have been, it may have been, I just do not know.

Chairman RYAN. I think that is what he is trying to get.

Mr. ELMENDORF. We are not trying to rebut what they do, we did our own analysis and I can speak to that, I cannot speak to what the administration did.

Mr. VAN HOLLEN. But Mr. Chairman just since we are now over the time.

Chairman RYAN. Yeah.

Mr. VAN HOLLEN. And the question is pretty simple, the question is whether or not the recovery bill, the stimulus bill, helped the economy relative to not doing a stimulus, and the answer from CBO and 80 percent of economists is that it helped the economy.

Chairman RYAN. Right and what Mr. Huelskamp is getting is the claims that were used to sell the stimulus were based on a multiplier that clearly did not materialize, which was much higher than what CBO claimed it would be. We will go to the record and figure out what that was. I think it was 2.1 or something like that.

Chairman RYAN. We are not suggesting you are selling anything, we are suggesting the administration was selling something and they oversold it.

Mr. VAN HOLLEN. We should just invite everybody to look at the Congressional Budget Office analysis on this exact issue that has been raised a couple times, which may clear that as a result of the recovery bill, we have saved or created over three million jobs. They talk about it on a year-by-year basis, and for those people that have those jobs, it is pretty meaningful .

Chairman RYAN. And the administration claimed unemployment would never get above 8, that millions more jobs would have been created, and they plugged in a multiplier that very few economists support or justify it. Mr. McClintock.

Mr. ELMENDORF. Can I say one more thing?

Mr. VAN HOLLEN. Not on my time.

Mr. ELMENDORF. Congressman Huelskamp, we are doing a report right now on the slow recovery. We are trying in fact ourselves to understand better where we went wrong in an effort to improve our forecast going forward, and we are writing this up in a way that it will be available to you and your colleagues I hope within a few months, as part of our preparation for our August forecast update.

Mr. HUELSKAMP. Mr. Chairman, I request 30 seconds to close.

Chairman RYAN. No, I actually started the mantra after your time expired.

Mr. HUELSKAMP. No, no, you did not. I gave you my time.

Chairman RYAN. Oh, you are right. Okay, go ahead, go ahead. Sorry.

Mr. HUELSKAMP. I appreciate that. And, you know, I was not around here, and I am going with the numbers that were provided by the administration, says it is 5.7 percent, that is in writing. So far often there have been different multipliers. But as we go forward, and I look forward to that report, one thing I will ask is well to put in the report if you can make an estimate as Ms. Black indicated, what is the economic impact of uncertainty because I am hearing that from job creators, and that is nowhere in your report. And that is a difficult thing to measure. With that I yield back my time.

Chairman RYAN. Thank you, and I apologize. Thanks for being the indulgence. Mr. McClintock.

Mr. MCCLINTOCK. That reminds me, the economists who said, well that might be true in practice, but how does it work in theory?

I think we have run a follow of McClintock's first law of political physics which is the more we invest in our mistakes the less willing we are to admit them. A corollary event is the conceit of the left that somehow a consensus determines science or economics. The sad fact of the matter is if 80 percent of the economists turn out to be wrong, the fact that it was 80 percent of them does not make it right, it is still wrong. And that has been the experience that we have had and why your testimony is being greeted with a certain degree of skepticism now. With respect to the question of default, does not the secretary of the Treasury have the authority to prioritize payments to assure the timely payment of the government's sovereign debt obligations?

Mr. ELMENDORF. I think that is right congressman.

Mr. MCCLINTOCK. I think it is too, so does the GAO, in fact, I think it is invented in the original act that established the Department of the Treasury. So, sovereign debt default then would not be an act of the Congress, it would be a malfeasance of the executive and not prioritizing payments to ensure a timely payment of the sovereign debt obligations.

Mr. ELMENDORF. I am sorry congressman I cannot speak to the legalities of this. I can speak, I think, to our sense of the economic consequences.

Mr. MCCLINTOCK. Ms. Castor called the budget passed by the house last year a disaster. I recall Standard & Poor's warning that a deficit reduction of $7 trillion dollars in the baseline over the next 10 years was what was necessary to preserve the AAA credit rating of the United States government. I specifically asked the head of their sovereign debt division if the budget adopted by the House last year, the so-called Ryan budget, would have preserved the AAA credit rating of the United States government. His answer was it would have. Do you have any reason to contradict that?

Mr. ELMENDORF. I have no view on that one way or another congressman.

Mr. MCCLINTOCK. So, we could have preserved the AAA credit rating of the United States government, but I have some friends on the left who seem to think that it is a disaster. Let me talk about the relationship between tax and deficit if I could. Tax has often been put forward as an antidote to deficits, you have essentially said that in your testimony. But are not taxes and deficits basically the same thing, I mean, is not a deficit simply a future tax? Are not taxes and deficits the only two possible ways for paying for spending?

Mr. ELMENDORF. I think that is right, congressman. Certainly, as you know, in the long run one cannot just continue to run up deficits either, in the long run we need to bring our spending and our taxing into rough correspondence with each other.

Mr. MCCLINTOCK. But the deficits are future taxes. Whether you are taxing today, or you are taxing tomorrow, which is what we call a deficit, you are still taxing and those are the two ways that you pay for spending. So it seems to me, that with apologies to the Clinton campaign, it's the spending, stupid.

Mr. ELMENDORF. Well, congressman, I think that when we run up the debt today that those commit us to do either more taxation or less spending in the future. But which of those it is depends on the decisions of the Congress.

Mr. MCCLINTOCK. Can you offer us any examples of a nation that has ever spent and borrowed and taxed its way to prosperity?

Mr. ELMENDORF. Well, I am not sure what you mean by that, congressman. I mean, prosperity comes ultimately from the ability of an economy to produce goods and services, it is from the amount and quality of the labor force, it is the amount and nature of the capital stock, it's productivity, and so on. Those are the drivers for productivity.

Mr. MCCLINTOCK. But going from theory to actual practice, I would look back over the 20th century and the beginning of the 21st century and I see Harding reducing spending as percentage of GDP in the early 20s, Truman reducing it in the mid-1940s, Reagan reducing it in the mid 1980s, and Clinton reducing it in the mid-1990s, and each period follows or is followed by a rather dramatic expansion of the nation's economy. And yet I see, when spending is dramatically increased, Hoover in the late 20s/early 30s, Roosevelt throughout the 30s, Bush in the 2000s, the economy has languished. What are we to draw from the practical experience that is quite consistent over the past century?

Mr. ELMENDORF. I think the practical experience is harder to interpret than you are suggesting, congressman. If one looks across, for example, across European countries, you asked, I know, different countries and how they perform. A table in front of me. Germany, which is one of the stronger European economies being relied on by others in Europe today, they have a much larger share of GDP collected in tax revenue before this downturn.

Mr. MCCLINTOCK. But again, tax revenue, that is not what I am talking about. I am talking about spending percentage of GDP.

Mr. ELMENDORF. Well, they have higher spending than we do, there are countries in Europe that have all sorts of different spending and tax policies.

Mr. MCCLINTOCK. Actually, I think I just saw a chart that actually measured in per capita dollars of per capita spending in the United States is higher than it is in those European countries.

Mr. ELMENDORF. We are richer than they are. So, share of our GDP goes further in dollars.

Mr. MCCLINTOCK. We continue these policies, we can fix that in a hurry, I am afraid.

Chairman RYAN. Thank you. Mr. Guinta.

Mr. ELMENDORF. Can I?

Chairman RYAN. Go ahead.

Mr. ELMENDORF. I know I am using your time, Mr. Chairman. Can I just say, you refer, congressman, to whether people invest in errors and then are not willing to admit them. I am not sure if you are referring to our analysis or to policy-making. But I would like to say on behalf of our analysis, that we continue to read the literature and we have in fact adjusted our range of estimates of the effects of the Recovery Act in response to what we have learned throughout that process. But we have not adjusted the range to include effects below zero, because we do not think that is consistent with the evidence, and only 4 percent of the economists seem think it is, and 80 percent in this survey that it is not. So again, although we do respond to the evidence, and are not afraid to admit that, we are very clear when we change our views and why. We think, again, with the great majority of economists, the Recovery Act was, on net, good for the economy on the past few years.

Chairman RYAN. Thanks. Mr. Guinta.

Mr. GUINTA. Thank you, Mr. Chairman. Was the stimulus bill, Recovery Act, the only way that we could have helped the economy?

Mr. ELMENDORF. No, congressman, I mean there are a whole collection of possible alternative policies that could have been, could have been enacted. And we have been asked a number of occasions now by the Senate Budget Committee to look at alternative ways of providing a boost to the economy, we have offered a menu of options and we have discussed what we think the likely effects would be and the pros and cons of different ways of perceiving. So there are many, many policies.

Mr. GUINTA. And is it also fair to say the Recovery Act could add to the deficit?

Mr. ELMENDORF. Yes. That is right.

Mr. GUINTA. And it did add to the debt?

Mr. ELMENDORF. Yes. That is right.

Mr. GUINTA. Okay. So, what is the effect of borrowing money, going into debt and deficit, have on private sector capital?

Mr. ELMENDORF. Well over the medium term and long term, that extra debt will crowd out private capital formation as we have said, and we said this in February of 2009, that the Recovery Act that was then was being discussed would be good for the economy in the short run, but absent other changes would be a drag later on.

Mr. GUINTA. So then as I look at the President's budget proposal for the next decade, I seem to recall seeing, I think, every year for the next 10, our deficit exceeds $1 trillion, and then our long-term debt continues to grow. Now I do not know what percentage of GDP is off the top of my head. So, to your point that at some point in the long term, which is what this report talks about, we do have to change, as you said, the ratio debt to GDP and we have got to change our tax revenue to our expenditures. Now, it is suggested by some that the way to do that is to increase taxes. If we increase taxes, let us say that we increase every single tax rate, does that necessarily suggest we are going to have more long-term revenue to the Treasury?

Mr. ELMENDORF. Well, in general, congressman, higher tax rates will lead to more revenues. Not proportionately higher, because there will be some effect on people's behavior, but in general, from the levels the U.S. is starting from today, or has been talking about the next decade, increases from that point to revenues in general. Now, could we find specific taxes where that was not true? Perhaps, I do not know, we have not checked in that way.

Mr. GUINTA. So there is an alternative than to just raising tax rates to trying to fix and solve this problem. We have, what is our revenue today? $2.2 trillion?

Mr. ELMENDORF. You would think I would know that, congressman, but I do not. We think this year the revenues will be about $2.5 trillion.

Mr. GUINTA. $2.5 trillion. But we will spend $3.5, $6 trillion?

Mr. ELMENDORF. Spend about $3.5 trillion.

Mr. GUINTA. Okay.

Mr. ELMENDORF. About $3.5, a little over, trillion dollars.

Mr. GUINTA. So we are still looking at a trillion dollar deficit.

Mr. ELMENDORF. We are. We do not think that will persist at that level under current law, or in fact under the President's budget. But the President's budget does have larger deficits than under current law.

Mr. GUINTA. And one of the things that I do want to get on the record and you may talked about it before, and I apologize if you have, in terms of health care entitlements, the CBO reports as 5.4 percent GDP of that spending in 2012 which goes up to 12 percent of GDP by 2050, so that is clearly a driver of our long term fiscal problems, is it not?

Mr. ELMENDORF. Well, that is the thing that is different from the past. That is the part that means that we cannot repeat the policies of the past. Again, whether that is addressed by you and your colleagues through changes in those programs in spending or other taxes is up to you. But the fiscal problem in balance just comes from the gap, not the tidbit from either side or the other.

Mr. GUINTA. However is we were to eliminate 100 percent of discretionary spending, we would still have a current deficit, and we still have long-term debt problem

Mr. ELMENDORF. Like I said, I have not tried the complete elimination but, as I said congressman, when I started, changes one makes in programs outside the health care program and Social Security can affect the magnitude of the changes needed in taxes or the large entitlement programs. But it does not eliminate the basic tradeoff that we need to either change taxes relative to their historical performance, change these programs relative to current law, or reduce some combination of those.

Mr. GUINTA. Would you be able to comment on what the unfunded liability numbers are on the mandatory side?

Mr. ELMENDORF. I do not know congressman. We do not calculate unfunded amounts in dollar terms like that, we generally show projections as shares of GDP, and we show some imbalances in the Social Security trust fund, and we show a fiscal gap that the economy as a whole, but it is not, that is just the gap between spending revenues, it is not meant to capture the present value of all future spending or all future revenues.

Mr. GUINTA. Okay. Thank you very much, I yield back.

Mr. ELMENDORF. Thank you congressman.

Chairman RYAN. Thank you very much. I think that concludes all member questions. Dr. Elmendorf, again, thank you and your team, Joyce and your team, for all your hard work in putting together this very insightful, very harrowing report together and this hearing is adjourned.

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

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