S. HRG. 113–518

# CONCURRENT RESOLUTION ON THE BUDGET FOR FISCAL YEAR 2015

## HEARINGS

BEFORE THE

## COMMITTEE ON THE BUDGET
## UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

**February 4, 2014—THE 2014 OUTLOOK: MOVING FROM CONSTANT CRISIS TO BROAD-BASED GROWTH**

**February 11, 2014—THE BUDGET AND ECONOMIC OUTLOOK FOR FISCAL YEARS 2014-2024**

**February 25, 2014—THE ECONOMIC AND BUDGET OUTLOOK FOR INDIVIDUALS, FAMILIES, AND COMMUNITIES**

**March 5, 2014—THE PRESIDENT'S FISCAL YEAR 2015 BUDGET PROPOSALS**

**March 12, 2014—THE PRESIDENT'S FISCAL YEAR 2015 BUDGET AND REVENUE PROPOSALS**

**May 6, 2014—THE PRESIDENT'S FISCAL YEAR 2015 EDUCATION BUDGET REQUEST**

**May 8, 2014—THE US ECONOMIC AND FISCAL OUTLOOK**

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# THE 2014 OUTLOOK: MOVING FROM CONSTANT CRISES TO BROAD–BASED GROWTH

**TUESDAY, FEBRUARY 4, 2014**

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
*Washington, D.C.*

The Committee met, pursuant to notice, at 10:38 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Whitehouse, King, Sessions, Crapo, and Johnson.

Staff Present: Evan T. Schatz, Majority Staff Director; and Eric M. Ueland, Minority Staff Director.

## OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. Good morning. This hearing will come to order. First of all, I want to welcome everyone to the first Senate Budget hearing in 2014 and thank Ranking Member Sessions and all of our colleagues who are joining us here today.

And I want to thank our witnesses as well. Dr. Mark Zandi, chief economist for Moody's Analytics, who will be here in just a few minutes—he is on a train, is my understanding; Robert Greenstein, president of the Center on Budget and Policy Priorities; and David Rosenberg, who is the chief economist and strategist of Gluskin, Sheff and Associates.

Right now, as many of you know, the Congressional Budget Office is sharing its baseline numbers and economic outlook for the next decade. We will have a hearing with CBO Director Elmendorf on that outlook next week.

But for our hearing today, I want to take some time to look back at where we have been and how I would like to see this Committee and Congress move forward in the years ahead.

There is no question Congress has spent far too much time over the past few years lurching from budget crisis to budget crisis, from one artificial deadline to the next, and from one partisan battle to another. That has had a real impact on our economy and on families across the country.

Last March, I was out in Lakewood, Washington, where I met a man who name is Matthew Hines. He and his wife both work at the Joint Base Lewis McChord. And when the across-the-board spending cuts, known as sequestration, hit, both he and his wife were furloughed. Together, they stood to lose about 40 percent of their income. Because of irresponsible budget cuts in D.C., Matthew worried his family would miss their mortgage payments.

He was working very hard—serving his country—doing the right thing. But because Congress was mired in partisanship and gridlock, his family was forced to pay the price. And I think that is just wrong.

We were sent here by our constituents to solve problems, not create them; to work together, not tear each other apart.

So I am hopeful that we here in this Committee and all of us in Congress can build on the foundation of the bipartisan budget deal we brokered last December and on the progress that we have seen since then.

Now is the time to move away from governing by crisis and move forward by investing in priorities that help families and communities all across the country.

Now, the senseless across-the-board cuts did not just hit defense workers like the Hines family. They also took a toll on education and Head Start programs.

In years past, the Denise Louie Education Center that is in Washington State had a waiting list for preschoolers. But last year, because of those cuts, the school had to start dropping kids from their program.

Across the country, more than 50,000 young learners were not able to attend Head Start.

Severe cuts slashed other important investments in medical research, in infrastructure, and in military readiness. And it did not end there.

At a time when families across the country have been reeling from the greatest economic downturn since the Great Depression, brinkmanship in Congress infused uncertainty into the economy.

Last September, the Budget Committee had a hearing on the detrimental impact of political uncertainty on jobs and the economy.

In fact, one of our witnesses today, Mark Zandi, was at that hearing, and he told us that since 2008, political uncertainty reduced real GDP by nearly $150 billion and increased unemployment by 0.7 percentage points.

I am glad Dr. Zandi will be here again to share his outlook on the economy today because since then, Congress has made some significant progress.

Late last year, after the Government shutdown and debt limit scare, Republicans dropped their demands and joined with Democrats to re-open the Government, prevent a catastrophic default by raising the debt limit without preconditions, and finally allow the budget conference that many of us here on the Budget Committee spent 7 months fighting to start.

When Chairman Ryan and I sat down together in the budget conference, we faced a lot of skepticism that we would be able to get anything done. Every bipartisan budget group that had met over the past few years had ended the same way: with gridlock and inaction. And coming so soon after the partisanship and bitterness surrounding the Government shutdown, many people thought there was just no way Democrats and Republicans could work together for the good of the country.

We came into our budget conference knowing we were not going to agree on everything. We came in with very different budgets, very different ideologies, and very different values and priorities. But we also came ready to listen to each other, put partisanship aside, find some common ground, and make some compromises.

Many of us wanted an agreement, not a fight. We aimed for what was attainable, and we were able to reach a deal that showed the American people that the dysfunction of the past few years was a choice made by a minority, not an inevitable fact of our divided Government.

That 2-year deal, the Bipartisan Budget Act, prevented a Government shutdown and set bipartisan spending levels through the end of 2015.

It replaced almost two-thirds of this year's across-the-board cuts to domestic investments. And it prevented another round of defense cuts that were scheduled to go into effect earlier this year.

The bipartisan budget deal was a step in the right direction. But it was only a step. It was not exactly the deal that Democrats would have done on our own. And I know it is not what Republicans would have done on their own.

But the agreement moved us away from the dysfunction that has defined Congress in the past few years. It proved that bipartisan work was possible. And now we all have a responsibility to keep that work going.

Congress has now built on that bipartisan success. After laying the groundwork in the budget deal, Chairwoman Mikulski worked with House appropriators, and together they were able to make critical investments in our country.

The bipartisan omnibus bill we passed last month expanded access to preschool. More 2-, 3-and 4-year-olds will get the tools they need to start kindergarten on strong footing.

For our national defense, the bill eliminated the threat of civilian furloughs in 2014. That means more hard-working Americans will not have to worry if their next paycheck will be enough to make ends meet.

And it made critical investments in transportation projects that put more people back to work and help make our roadways and transit systems safer and less congested.

In addition to that important legislation, just last week, under the leadership of Chairwoman Debbie Stabenow, our colleague here on the Committee, an agreement was reached on a bipartisan farm bill.

So we have bipartisan momentum right now. We should build on that by investing in broad-based economic growth and expanding opportunities for families, small business owners, and communities across the country.

That does not mean we lose sight of or ignore our long-term fiscal challenges. Of course not.

Since 2009, the deficit has been cut in half. We need to build on that work, fairly and responsibly.

I know Democrats are at the table ready to do that, and I am hopeful this will be a year that Republicans are ready to join us and make some compromises.

But we also need to make sure we do not let the reality of our long-term fiscal challenges prevent us from addressing the reality of our short-term economic challenges.

Families are struggling today. Workers are fighting to get back on the job—or barely keeping their heads above the water with the jobs they do have.

Our country is not making the investments that we need to in education, in research, or in innovation to compete and win in the 21st century global economy.

Our infrastructure is crumbling, and we are not doing what we need to do to leave a stronger country for our children than the one we got from our parents.

So we need to get to work. For starters, I believe we should increase the minimum wage. One of our witnesses here today, Robert Greenstein, testified last week before the House Budget Committee. I will echo a point that Mr. Greenstein made there.

Raising the minimum wage would boost the upward economic mobility of low-wage workers. A pay increase to $10.10 would help families make ends meet, and it would expand opportunities for them to get ahead.

Last week, in his State of the Union address, President Obama stressed that early childhood education is one of the smartest investments we can make, and I could not agree more. As a former preschool teacher, I know the difference it can make in a child's life.

Preschool offers young learners the building blocks they need to go to kindergarten, ready to tackle a curriculum. The path to greater opportunity in this country starts with a quality education.

So I will be working hard to make sure more students have access to preschool, to world-class grade schools, and to higher education.

Those are just a few examples of the work we should be doing. But divided Government requires that Republicans and Democrats work together. That is the only way we will enact policies that solve problems and help families and businesses by creating broad-based economic growth and increased opportunity.

Just when we have the opportunity to make progress on investing in the future, I worry that some Members of Congress are falling back into their old habits and planning to manufacture a crisis over the debt limit.

And just like last time, they cannot seem to agree on which ridiculous demand to make in exchange for ensuring the United States pays its bills.

Secretary Lew had an important message for these members yesterday: Time is running out. And the longer Republicans take to dream up empty debt limit demands, the more economic uncertainty and harm they will cause for workers and families and businesses.

So I hope those Republicans who are engaging in brinkmanship will listen to Secretary Lew and to our discussion today. And I hope they will do right away what they have ultimately done twice in one year: give up their ransom demands and raise the debt ceiling without strings attached and work with Democrats on the real challenges that we face.

I recently got an update from the Hines family I talked about a few minutes ago, and it reminded me of what is at stake here. Matthew said he and his wife survived last year's furloughs. He just hopes they never have to go through that again.

Thankfully, because of our bipartisan budget deal, his family and his coworkers will not have to worry about layoffs and furloughs.

When Congress gets serious about putting families and communities first, we can solve problems. We can help people like the Hines family, and we can move the country forward.

I invite all of our colleagues—Democrats and Republicans—to join me this year in building on the bipartisan work we have done and investing in our national priorities.

Together we can move forward, beyond the constant crises of recent years, to make sure businesses can grow and communities can thrive.

Together we can expand opportunity so all Americans get the chance they need to succeed.

And with that, before we hear from our witnesses, I will turn to my Ranking Member, Senator Sessions, for his opening remarks.

**OPENING STATEMENT OF SENATOR SESSIONS**

Senator SESSIONS. Thank you, Madam Chairman. The recovery from the 2009 recession seemed to be solid at first, but it has not come close to meeting the projections of the Obama administration's, OMB, the Federal Reserve, Congressional Budget Office, or others.

For example, every year when OMB and others have made their 2-year GDP projections, they have missed, not just a little bit, and these misses were not divided, with some too high and some too low. Everyone projected markedly higher growth rates than actually occurred.

Specifically, the August forecast team at the Federal Reserve projected just 2 years ago, 2011, that growth this past year, 2013, would be 4.1 percent when, in fact, it came in at a very weak 1.9 percent. CBO had estimated that we would have 3.5 percent. Good growth rates. They did not occur.

So some will say that is because we have a financial recession, but in 2011 and 2012, these experts knew this was a financial recession. Their projections were based on something—we do not know what—that did not come true.

For example, in December of 2012, at the very beginning of the 2013 year, the Federal Reserve projected growth would be between 2.3 and 3 percent. It came in at 1.9 percent. President Obama's team, OMB, also produced 2-year growth projections that were higher than reality.

So, additionally, the stock market experts have told us we will have a correction now. This is just a correction, but we have lost 6 percent since the beginning of the year. So forgive me if I am a bit concerned about where we are.

More seriously, I am not attacking OMB, CBO, or the Fed for incompetence or deception. My concern is deeper. It is why our economy is failing to achieve liftoff even 4 years after the recession. The Government and Federal Reserve remain quite proud of themselves for their heroic response to the financial crisis. I know business profits are strong, and the stock market did extraordinarily well last year. That gives us hope.

But it is time to face facts. All is not good, especially for middle-class working Americans. Middle-class family incomes have declined since 2000, and the decline has accelerated since 2010, since the recovery was declared. Approximately 16 million people have been added to our population since 2000, but 2 million fewer people are working today than they were in 2007. Nearly two-thirds of the jobs created in 2013 counted in our employment surveys were part-time jobs. We have the lowest workforce participation rate since 1974, and it is not getting any better.

The Labor Department reported last month that the economy produced only 74,000 jobs for December—shockingly low and well below the 200,000 jobs per month actually needed to increase employment in America.

So it seems to me the fiscal policies of our Government and the monetary policies of the Federal Reserve have relied on bold stimulus-type initiatives—spending more, borrowing more, and dramatic and unprecedented purchases of Government debt by the Federal Reserve, all to change the grim dynamic that is out there for the American people.

President Obama pushes more Government spending, more regulations, more investments, expansion of Government, and more welfare as the proper response to this crisis we are in, especially to help the working poor. I know he is sincere in that. Specifically, the Government would set wages and provide more support payments for those not working. A new Government-directed health care system is created that, we are told, will reduce the costs of health care and help all of us and help the economy. But is this a compassionate response that will actually work to help the millions of Americans that are hurting today? I have never thought this is a successful long-term approach.

Our debt margins have been eliminated. We cannot keep borrowing more. Taxes cannot keep going up. They have gone up significantly. We still face Medicare and Social Security crises. The Ryan-Murray spending agreement got Congress out of a political bind and avoided a conflict, but it did not change the debt course of our country. It taxed a little more and it spent a little more.

We have tried taxing, spending, and borrowing to jump-start our way to prosperity. The President proposed more of the same in his State of the Union. It has not worked. This will not work. We need a course correction.

I am going to suggest some solutions that will help American workers without adding to our debt. We need to promote more American energy, produce more American energy, fair trade, defending the American worker on the world stage, better immigration policies, welfare and tax reform, a leaner more productive Government, the elimination of regulations that destroy jobs, transforming the welfare office into a job training, job promotion office, and more growth that is created when we get off a debt course that we are now on that leads us to continuing increases in our annual deficits in the years to come.

And I know we need to work together on a bipartisan way to get past difficulties that we have here, but my Democrat colleagues are not always right, at least in my opinion, and their ideas and visions for helping people in America are not always working. And, in fact, many times they are not working.

So I hope that we can agree to take some steps toward improving our financial circumstances when the debt ceiling is reached. Why shouldn't that be a point in time in which this country can evaluate where we are going, how we reached the debt ceiling so fast, and what we can do to improve it? Mr. Lew says he will take no reform whatsoever as a part of raising the debt limit, that the credit card has reached its limit, no one—Mom and Daddy cannot question the spending that has gone on, and we cannot make any reforms. I mean, how reasonable is that? This is the same Mr. Lew that sat at that table there and said the President's budget would spend only money that we have and not add to the debt anymore. What a thunderously false statement, one of the greatest financial misstatements in the history of the world. And now he is telling us we can do nothing to contain spending, that we have to just ratify and raise the debt ceiling without even a peep? How silly is that?

We need to be thinking about how to get this country on a sound path, and one way to get us on a sound path is to eliminate the debt cloud that is over this economy and put ourselves on a course that the whole world will recognize is a sound financial course.

So I would say, Madam Chairman, we share the same goals. We want to see this economy grow. We want to see a growing economy produce more tax revenue and help us reduce our deficits. We want to see a growing economy that helps workers find jobs, that ends flat wages and reducing wages and creates naturally through the process of free enterprise higher wages for American workers. The question is how to get there. I just do not believe tax, spend, and borrowing is the right way. I think there is a better way, and I thank the Chair.

Chairman MURRAY. With that, we are going to turn to our witnesses, and, Mr. Greenstein, we will start with you.

## STATEMENT OF ROBERT GREENSTEIN, PRESIDENT, CENTER ON BUDGET AND POLICY PRIORITIES

Mr. GREENSTEIN. Thank you very much and good morning.

As you know, deficits have been coming down in the past few years. In 2013, the deficit was about 4 percent of GDP. The new CBO projection is it will come down to about 2.5 percent of GDP by 2015. Of course, in subsequent years and decades, it will climb, and we clearly have more work to do on our long-term fiscal challenges.

But there has been significant progress. We project, if you look out three decades under current policies, that the debt in 2040 would be somewhere in the rough vicinity of 95 percent of GDP. Now, that is too high, but it is much lower than the more than 200 percent of GDP that we and other analysts were forecasting for 2040 only a few years ago.

The improvement in the long-term projections primarily reflects two factors:

First, health care cost growth has slowed considerably. CBO has lowered its estimate of Medicare and Medicaid spending over the period from 2010 to 2020 by over $1 trillion relative to the estimates it made in 2010.

And, second, counting sequestration, policymakers have enacted legislation that reduces the deficit about $4 trillion over the coming decade with nearly 80 percent of the non-interest savings coming from spending cuts.

Now, these figures reflect the fact, reflected in the budget agreement in December, that the costs of sequestration relief and relief from the scheduled Medicare physician payment cuts, it is increasingly clear, are being paid for, and the one policy uncertainty in this area is whether policymakers also will offset the cost of extending the tax expenditures known as "tax extenders."

We recommend that policymakers commit to doing so, that they apply to legislation to continue the extenders the same principle they are applying to sequestration relief, to the Medicare physician payment relief, and that it now appears clear Congress will be applying to Federal unemployment relief if that goes forward.

If policymakers pay for the cost of continuing the tax extenders, we estimate that would reduce the debt in 2040 to somewhere in the range of 85 percent of GDP, or thereabouts—still too high, but significant progress. And given political gridlock, this is likely to be one of the only steps policymakers have a shot at enacting this year that would materially improve the long-term fiscal outlook.

As I have noted, ultimately more will need to be done with our fiscal challenges, but in the near term, the increased certainty that the December budget agreement brings for the next 2 years also gives Congress the opportunity to focus on a number of pressing issues that have received insufficient attention. Let me very briefly note four of them.

Number one, I believe policymakers should temporarily extend the unemployment benefits that have expired. The Congressional Budget Office estimates the economy will have up to 300,000 more jobs by the fourth quarter of 2014 if those benefits are extended for the coming year.

Second, as the Chair has alluded to, I do recommend that policymakers help lower-wage workers by strengthening the minimum wage, which is significantly below its purchasing power level of a number of earlier decades.

Third, single workers who are paid low wages are the one group of workers in America whom the Federal tax system taxes into or deeper into poverty. The main reason for that is that the earned income tax credit for these workers is tiny. A childless adult working full-time year round at the current minimum wage earning $14,500 a year is considered to have income too high to qualify for the EITC, even though that individual pays over $1,500 a year in Federal income and payroll taxes. And a worker whose wages put them right at the poverty line, $12,000 for a single individual, is required to pay close to $1,000 in Federal income and payroll taxes, gets maybe $180 earned income credit, and is literally taxed into poverty. So I would recommend that Congress look at strengthening the earned income credit for workers who are not raising minor children, a recommendation that a number of experts and analysts across the political spectrum have been making, looking at the fact that it could induce more young men to enter the labor force, and it could have positive effects on marriage, crime, and incarceration rates. This is why you see people like former Bush adviser Glenn Hubbard recommending this as a policy to pursue.

Lastly, we will need to return before 2016, although we do not need to do it this year, to the issue of discretionary funding levels. The budget agreement covered 2014 and 2015. By 2016, non-defense discretionary funding will drop below the post-2013 sequestration level, adjusted for inflation, and will fall to the lowest level as a share of the economy since the 1950s, and those figures understate the coming crunch.

For example, veterans health care does not just grow with the caps. It has been growing and will probably need to grow around 7 or 8 percent per year. That has been its history. And the Pell grant program faces a funding shortfall starting in 2016, which, if not addressed, will result in large cuts in that program that reduce the ability of students from low-income families to attend college and get a chance at opportunity and upward mobility. There are issues in research and infrastructure. There are issues in defense. In short, after the 2 years the current budget deal covers, we really will need a new budget agreement. The Nation cannot afford to neglect funding for education, scientific research, and the like. That is not something Congress has to do this year. It is something we will need to get back to in 2015.

Let me stop there. My time has expired. I look forward to answering questions.

[The prepared statement of Mr. Greenstein follows:]

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# Testimony of Robert Greenstein

## President, Center on Budget and Policy Priorities
## Before the Senate Budget Committee
## February 4, 2014

I appreciate the invitation to testify today on current budget trends and opportunities in light of the recent bipartisan budget agreement and the improving budget outlook. The budget agreement, while modest, helped to mitigate some of the worst effects of sequestration this year and restore some normality to the appropriations process. In addition, the fiscal outlook over the medium and long term has improved markedly over the past several years. Challenges remain to put the budget on a sustainable path over the long term, but these recent changes in the fiscal landscape (which exceed what any of us expected) give Congress a chance to move away from the gridlock over budget battles that have preoccupied Washington but failed to produce a "grand bargain," and to begin focusing to a greater degree on addressing other pressing problems that have been neglected in recent years.

My testimony begins with a review of the budget outlook and then turns to several issues to which Congress should give high priority: promoting job creation and addressing significant problems looming as a result of the seriously inadequate levels of funding available for non-defense discretionary programs, particularly starting in 2016. I conclude with an overview of issues related to our long-term budget challenges.

### I. The Budget Outlook

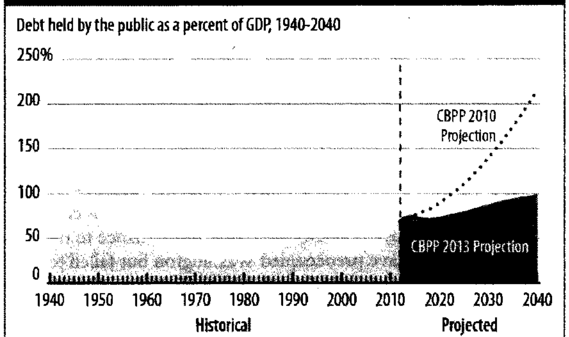
The deficit peaked both in dollar terms and as a share of the economy (gross domestic product, or GDP) in 2009. The spike was due to the Great Recession and our efforts to combat its negative effects: federal spending rose because of "automatic stabilizer" programs such as unemployment insurance and SNAP, as well as temporary stimulus measures; tax revenues declined as individuals and businesses earned less and because of tax-cut stimulus measures; and GDP declined as the economy slowed.

Since then, deficits have been on a marked downward path. In 2013, the deficit fell to about 4 percent of GDP — less than half of its peak — and the debt held by the public stood at 72 percent of GDP. The Congressional Budget Office (CBO) will release new budget projections today, but using last year's CBO estimates, we project that the deficit will fall to about 2 percent of GDP in 2015 — less than the average of the four decades from 1969 to 2008. Through the end of the decade, deficits as share of the economy will continue to remain low, although they will begin to rise modestly toward the end of the decade and gradually climb to significantly higher levels.

It is important to note that the near-term deficit reduction steps taken in recent years, while contributing to the improvement in the long-term fiscal outlook, were not good for our near-term economic growth and reflected a "too much, too soon" approach to deficit reduction. It is good news that our longer-term fiscal issues have eased. But it would be preferable to have substantially *less* fiscal contraction while the economy is struggling to produce enough jobs — indeed, more stimulus is still called for — coupled with *greater* emphasis on longer-term deficit reduction.

Last June, we released an analysis of the budget over the next three decades.[1] We found that by 2040, the debt would grow to 99 percent of GDP. These estimates were in line with those released by other organizations such as CBO, the Committee for a Responsible Federal Budget (CRFB), and the Center for American Progress. None of these estimates predicted the explosive debt trajectory that was common in previous long-term projections, including our own. (See Figure 1.)

Figure 1
Debt to GDP Ratio




Source: Historical data from the Office of Management and Budget; projections from CBPP based on Congressional Budget Office, Joint Committee on Taxation, and Social Security and Medicare Trustees data

The improvement in the long-term projections primarily reflects two factors. First, health care cost growth has slowed considerably. It's not yet clear what portion of that slowdown is ongoing and what portion is temporary, but most analysts — including CBO — see accumulating evidence that a significant portion is due to reasons other than the weak economy and is likely to continue. Furthermore, current health care costs — the base level from which future cost growth will occur — are substantially below projections from only a few years ago. CBO has lowered its estimate of Medicare and Medicaid spending over the decade from 2010 to 2020 by *$1.2 trillion*, relative to its March 2010 estimate.

The second and more significant factor is that policymakers have enacted substantial deficit reduction since 2010. The 2011 Budget Control Act (BCA) has sharply cut projected discretionary spending. The American Taxpayer Relief Act (ATRA) enacted in January 2013 increased tax revenues. These changes have reduced projected deficits by $2.8 trillion between 2014 and 2023, not counting the future cuts from sequestration. If the sequestration cuts are included, the total

[1] Richard Kogan, Kathy Ruffing, and Paul Van de Water, "Long-Term Budget Outlook Remains Challenging, But Recent Legislation Has Made It More Manageable," Center on Budget and Policy Priorities, June 27, 2013, http://www.cbpp.org/cms/?fa=view&id=3983.

grows to $4 trillion over the decade, with 79 percent of the non-interest savings coming from spending cuts and 21 percent from revenue increases.

Our long-term projections treated some future policy uncertainties cautiously; for instance, we assumed that policymakers would abide by the original BCA caps after 2013 but would not allow any additional sequestration cuts to take effect. However, with December's bipartisan budget deal, which paid for cancelling part of the sequestration of discretionary funding in 2014 and 2015 with spending cuts and fees, any further easing of sequestration will likely have to be offset with other savings.

Similarly, we had assumed that policymakers would continue to prevent deep cuts in Medicare physician payments caused by the Sustainable Growth Rate (SGR) formula but would ***not*** offset these costs. But there appears to be strong bipartisan support for offsetting the cost of a permanent solution to the SGR problem (as well as for offsetting temporary relief if a permanent solution isn't enacted).

Paying for easing sequestration and for a permanent SGR fix (or a series of temporary fixes) would have a significant impact on the long-term outlook. We estimate that it would reduce the debt from 99 percent of GDP in 2040 to roughly 90 percent.

The other major policy uncertainty is whether policymakers will offset the cost of extending a group of largely corporate tax expenditures (the "tax extenders") that expired at the end of last year. We strongly recommend that policymakers commit themselves to offsetting the cost of the extenders.[2] Policymakers should apply to legislation to continue the tax extenders (which, as the term "tax expenditures" implies, are largely spending in the form of subsidies delivered through the tax code) the same principle they are applying to SGR relief and sequestration relief and now appear certain to apply to any extension of federal unemployment relief — that it must be paid for.

As you know, Congress has failed to agree to date on extending expired federal emergency unemployment insurance (UI), with the issue of offsets being the primary stumbling block, even though this is a temporary program that poses almost no long-term budgetary risk and thus has a negligible effect on the long-term budget outlook. In contrast, the tax extenders are temporary in name only, as Congress extends them year after year, typically without much scrutiny because their costs haven't had to be offset. In this case, the impact on our long-term fiscal problems is large. Paying for continuing these provisions also would create an opportunity to pare inefficient tax subsidies, with which the tax code is replete.

If policymakers paid for the cost of extending these tax provisions, we estimate that it would (in combination with offsetting the cost of sequestration and SGR relief) reduce the debt in 2040 from roughly 90 percent of GDP to about 80 percent. That would only be slightly higher than today's debt-to-GDP ratio and would represent a marked improvement. In fact, given political gridlock,

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[2] Chuck Marr and Nathaniel Frentz, "Paying for "Tax Extenders" Would Shrink Projected Increase in Debt Ratio by One-Third," Center on Budget and Policy Priorities, December 9, 2013, http://www.cbpp.org/cms/?fa=view&id=4058; and Chuck Marr, "Paying for Jobless Benefits But Not 'Tax Extenders' Has It Backwards," Off the Charts Blog, Center on Budget and Policies Priorities, January 13, 2014, http://www.offthechartsblog.org/paying-for-jobless-benefits-but-not-tax-extenders-has-it-backwards/.

this is likely to be the only step policymakers will have a shot at enacting in 2014 that would substantially improve the long-term outlook.

We will update our long-term budget estimates in coming weeks, incorporating the CBO projections being released today, and we expect that they will continue to show the budget as being significantly more manageable than the projections of a few years ago. At the same time, more deficit reduction will ultimately be needed. If the projected debt ratio in 2040 were 90 percent or even 80 percent of GDP, it would still be higher than in recent decades and than what most analysts think would be best for the economy. At these debt levels, interest costs would consume too much of the budget, squeezing out other priorities. We also recognize that projections far into the future can be off by large margins.

On the one hand, the improvement in the outlook has diminished the urgency around these issues. On the other hand, policymakers will eventually need to do more to address our long-term fiscal challenges. In due course, policymakers will likely need to take additional steps to address the rising debt-to-GDP ratio at the end of the decade and eventually to put the debt ratio on a downward path. To do that successfully, and in a way that protects poor and vulnerable families and individuals, avoids further exacerbating the economic trends spawning ever-widening income disparities, and invests adequately in the building blocks of our economy will require *both* additional revenues *and* further spending reductions. There isn't a sound path to lower debt in future decades that doesn't include contributions from both revenues and spending.

In the near term, however, the increased certainty that the December budget agreement brings for the next two years — which would be significantly enhanced by a prompt, crisis-free resolution on the debt ceiling — gives Congress the opportunity to focus on a number of pressing issues important for both future economic growth and Americans' well-being that have been neglected in recent years.

The next section of this testimony focuses on two issues that I recommend Congress address in the coming two years: job creation and adequate funding for non-defense discretionary programs.

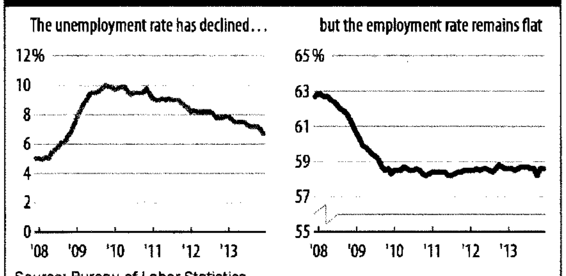
## II. Next Steps for Congress

Congress should turn its attention to the issue of jobs. We need to do more now to promote stronger job growth, as well as to promote opportunity and mobility. This section discusses four specific job-related policies: a temporary UI extension that keeps demand higher, an increase in the minimum wage, an expansion of the Earned Income Tax Credit (EITC) for childless workers, and a modest program of subsidized jobs, primarily in the private sector. It then focuses on non-defense discretionary programs, which include key investments in basic research, infrastructure, and education that can boost the nation's future productivity but that will face significant funding shortfalls.

### Extend Expired Unemployment Benefits

To ensure that poverty doesn't get worse in the near term and to support the still-sluggish economic recovery, policymakers should temporarily extend federal jobless benefits for long-term unemployed workers, a program known as Emergency Unemployment Compensation (EUC). Although the unemployment rate has fallen to 6.7 percent, much of that decline reflects abnormally

Figure 2
Unemployment Rate a Poor Measure of Health of Current Labor Market

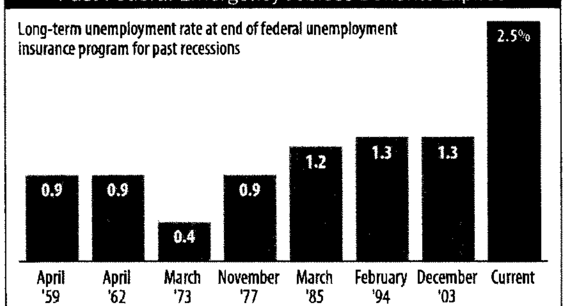



Source: Bureau of Labor Statistics

slow growth in the labor force due to limited job opportunities. The more telling metric is the percentage of people aged 16 and over who have jobs, which fell markedly during the recession and has recovered only modestly since. (See Figure 2.)

Further, the long-term unemployment rate — the percentage of the labor force that has been out of work more than six months — is nearly *twice* as high as when *any* of the emergency federal UI programs enacted in the previous seven major recessions expired. (See Figure 3). While Emergency Unemployment Compensation is a temporary program, economic conditions haven't yet improved enough to end it.

Figure 3
Long-Term Unemployment Much Higher Now Than When Past Federal Emergency Jobless Benefits Expired




Source: Bureau of Labor Statistics, Department of Labor Employment and Training Administration

Another piece of evidence that illustrates this reality is that, even when EUC benefits were still being provided in the fall, ***the number of long-term unemployed workers receiving no unemployment benefits was higher than at the depths of the recession,***[3] because so many unemployed workers had exhausted their benefits, Congress had reduced the duration of benefits, and some states had done so, as well. Furthermore, the percentage of unemployed workers receiving regular state UI benefits — the only benefits available if EUC benefits aren't reinstated — has fallen to historically low levels of roughly 26 percent.[4]

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[3] National Employment Law Project, "More Than Two Million Unemployed Workers Will Lose Jobless Aid by Early 2014 If Congress Allows Federal Benefits to Shut Down at Year's End," November 2013, p. 4, http://www.nelp.org/page/-/UI/2013/Issue-Brief-Two-Million-Unemployed-Lose-Federal-Jobless-Aid-Shut-Down.pdf?nocdn=1.

[4] Council of Economic Advisers and Department of Labor, "The Economic Benefits of Extending Unemployment Insurance," January 2014, Figure 4, p.10, http://www.whitehouse.gov/sites/default/files/docs/updated_ui_report_-_final.pdf.

Unemployment insurance is one of the most cost-effective ways to help a weak economy. Jobless benefits go to people who need the assistance to make ends meet, they spend the funds quickly, and the spending ripples through the economy. Without the consumer spending that those benefits generated, the Great Recession would have been even deeper and the recovery even slower. CBO estimates that the economy will have *up to 300,000 more jobs* in the fourth quarter of 2014 if the federal UI benefits are extended than if Congress doesn't reinstate them.

While December's bipartisan budget agreement provides a modest boost to the economy in 2014, the economic drag caused by expiration of federal emergency jobless benefits will likely negate that effect.

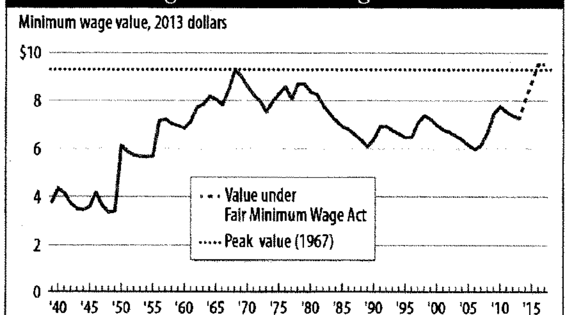
### Increase the Minimum Wage

Policymakers should help low-wage workers by strengthening the minimum wage.[5] Today's minimum wage is 22 percent below its late 1960s peak, after adjusting for inflation. Increasing the minimum wage to the $10-an-hour range would help in addressing some of the unfavorable trends facing low-wage workers, including stagnant or falling real wages, too little upward mobility, and a deficit of bargaining power that leaves them solidly on the "have-not" side of the inequality divide.

The Fair Minimum Wage Act of 2013 (FMWA) would raise the minimum wage from $7.25 to $10.10 in three annual increments and then index it to inflation. This would restore the purchasing power of the minimum wage to about its late-1960s peak. (See Figure 4.)

Figure 4

Fair Minimum Wage Act Would Restore Wage's Lost Purchasing Power




Note: Inflation adjustments reflect CPI-U-RS (Research Series)

Sources: Fair Minimum Wage Act, Congressional Budget Office, Bureau of Labor Statistics

The question of whether raising the minimum wage reduces employment for low-wage workers is one of the most extensively studied issues in empirical economics. The weight of the evidence is that for minimum wage levels in the range now being discussed, such impacts are small, and that increases of the size that's been enacted in the past — and would occur under the proposals now being discussed — are a significant net benefit to low-wage workers as a group. Raising the

[5] Jared Bernstein and Sharon Parrott, "Proposals to Strengthen Minimum Wage Would Help Low-Wage Workers, With Little Impact on Employment," Center on Budget and Policy Priorities, January 7, 2014, http://www.cbpp.org/cms/?fa=view&id=4075.

minimum wage also would lower poverty to some degree[6] and help push back against rising inequality.

Some opponents of raising the minimum wage argue that it would primarily benefit teenagers working for extra money, but the large majority of those who would benefit are adults, most of them women. Indeed, the average worker who would benefit brings home half of the family earnings. This reflects the fact that the low-wage workforce has gotten older (and more educated) in recent decades: the share of low-wage workers (those earning less than $10 per hour in 2011 dollars) who are between ages 25 and 64 grew from 48 percent in 1979 to 60 percent in 2011. The share with at least some college education grew from 25 percent to 43 percent.

But while we strongly support an increase of this magnitude in the minimum wage, that's only one step.[7] As discussed below, an expanded Earned Income Tax Credit (for workers not raising children) could be effectively combined with an increase in the minimum wage. While some suggest that the EITC obviates the need for a minimum-wage increase, both a strong EITC and an adequate minimum wage are needed to ensure that work "pays" for those in low-wage jobs and to avoid placing too great a burden on either employers or taxpayers (as would occur if policymakers tried to "make work pay" by relying largely or exclusively on just one or the other of these two policies). The two policies are complements, not alternatives.

### Strengthening the EITC for Childless Adults

Policymakers have made substantial progress in recent years in "making work pay" for low-income families with children by strengthening the EITC and Child Tax Credit. Yet low-income workers *not* raising minor children receive little or nothing from the EITC. For example, a childless adult working full time at the minimum wage is ineligible for the EITC, because his earnings exceed the very low income limit for the tiny EITC for workers not raising minor children. Partly as a result, childless workers are the sole group of workers whom the federal tax system taxes into — or deeper into — poverty.

Moreover, all childless workers under age 25 are flatly ineligible for the EITC, so young people just starting out receive none of the EITC's proven benefits, such as promoting work,[8] alleviating poverty, and supplementing low wages.

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[6] See, "Minimum Wages and the Distribution of Family Incomes," Arindrajat Dube, December 2013, https://dl.dropboxusercontent.com/u/15038936/Dube_MinimumWagesFamilyIncomes.pdf.

[7] To reduce poverty and increase opportunity, there are a number of other policy and program changes we also should pursue, including extending high-quality early education to more low-income children and providing help paying for child care to more low-income parents so they can look for and accept jobs and make ends meet. Another area where there are new, promising results from demonstration projects is in initiatives to help more low-income students not only attend, but successfully complete, two-year and four-year college degrees, which generally translates into better jobs and higher earnings. And just as it is important to improve children's preparation for school and what happens after high school, continued efforts to help low-income children succeed in elementary, middle, and high school are important as well. Education will not solve every problem. But it certainly can make a significant difference in children's future prospects.

[8] For a summary on research on the EITC, see Chuck Marr, Jimmy Charite, and Chye-Ching Huang, "Earned Income Tax Credit Promotes Work, Encourages Children's Success at School, Research Finds," Center on Budget and Policy Priorities, Revised April 9, 2013, http://www.cbpp.org/cms/?fa=view&id=3793.

The average credit for those eligible childless workers who do qualify for the credit is very small: just $270, or one-tenth the average $2,790 credit for filers with children. In addition, the childless workers' EITC begins phasing out when earnings exceed $7,970, or just 55 percent of full-time, minimum-wage earnings.

As a result, a childless adult working full time throughout the year at the current minimum wage, and thus earning $14,500, receives no EITC. This worker has a federal income and payroll tax burden of $2,669 in 2013 (counting the employer share of the payroll tax), or $1,560 (not counting it), which is a very large tax burden for someone with income this low. And a childless adult with wages equal to the Census Bureau's poverty line (projected at $11,905 in 2013) faces a federal income and payroll tax burden of $1,826 ($915 not including the employer share of the payroll tax), while receiving an EITC of only $186. *Such workers are literally taxed into poverty.*

Providing a more adequate EITC to low-income childless workers and lowering the eligibility age so younger workers can qualify would have several important benefits beyond raising these workers' incomes and helping offset their federal taxes. Some leading experts from across the political spectrum believe that an expanded credit would help address some of the challenges that less-educated young people (including young African-American men) face, including low and falling labor-force participation rates, low marriage rates, and high incarceration rates.

President Obama called for expanding the EITC for these workers in his recent State of the Union address, and support for this policy is broad. In part because an expanded EITC for childless adults is pro-work and pro-marriage, it has gained substantial support among a growing number of conservative, as well as among centrist and progressive, analysts. For example, former George W. Bush economic advisor Glenn Hubbard wrote recently, "Increasing the credit for childless workers to an amount closer to that for families with children would augment the direct work incentive and help counter poverty among the working poor."[9]

Similarly, the American Enterprise Institute's (AEI) Michael Strain recently noted that the EITC "gives very little help to childless workers" and called for amending the EITC "to offer more support to childless workers."[10]

Such bipartisan interest in the EITC isn't surprising; the credit has enjoyed broad bipartisan support over the years. President Ford signed it into law, and President Reagan lauded it as one of our best anti-poverty programs and proposed and signed a major EITC expansion because the credit helps low-income people struggling to make ends meet while encouraging work and personal responsibility.

### Subsidized Employment

Policymakers should also look to create subsidized jobs, primarily in the private sector. The Recovery Act provided modest funding to states that they could use for several purposes, including

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[9] Glenn Hubbard, "Tax reform is the best way to tackle income inequality," *Washington Post*, January 10, 2014, http://www.washingtonpost.com/opinions/tax-reform-is-the-best-way-to-tackle-income-inequality/2014/01/10/112710ea-68ca-11e3-a0b9-249bbb34602c_story.html.

[10] Michael Strain, "More than the Minimum Wage," *National Review*, December 11, 2013, http://www.nationalreview.com/article/365999/more-minimum-wage-michael-r-strain.

subsidized jobs. Thirty-nine states and the District of Columbia, representing a real cross-section of the country, established subsidized jobs programs for jobless low-income parents and youth. About half of those states had Republican governors; the other half had Democratic governors.

States worked with private and non-profit employers, as well as government agencies, to create these subsidized job positions — but most of the job placements were in the private sector. Many of the programs worked directly with private employers and required them to contribute to the costs of providing a subsidized job placement. States adopted a variety of approaches regarding the maximum wage level that could be subsidized and how long the wage subsidy could last per employee.[11] Typically, employers created positions that low-income parents or youth filled for temporary periods such as six months to a year.

The program proved highly successful. Over a 1½ year period, these states placed 260,000 low-income parents and young people in subsidized jobs. Moreover, the Economic Mobility Corporation (EMC) studied what happened to participants in these subsidized jobs programs and found the programs did exactly what they were supposed to do — help disadvantaged jobless individuals find work during hard economic times. The study also provides evidence that the jobs programs improved some participants' chances of finding ***unsubsidized*** jobs when their subsidized job position ended.[12] And the study indicated that the long-term unemployed benefitted most.

The Recovery Act funding for the subsidized jobs program expired in 2010, but there is growing support among analysts across the political spectrum for this type of strategy, as it helps to address several fundamental problems — too few jobs (especially in the current economy) for less educated workers, a substantial number of workers who have been out of work a long time, and the lack of sufficient work experience among significant parts of the low-income population. Conservatives who recommend such an approach include Ron Haskins, co-director of the Brookings Center on Children and Families and former White House advisor to George W. Bush,[13] and Kevin Hassett, Director of Economics at the American Enterprise Institute.[14]

## Non-Defense Discretionary Funding

Non-defense discretionary (NDD) programs provide a broad set of public services, including education, environmental protection, border security, veterans' health care, scientific and medical research, transportation, economic development, low-income assistance, law enforcement, and international humanitarian and development assistance. This budget category provides grants to

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[11] For more information on how these programs were structured and the different approaches that states adopted, see "Creating Subsidized Employment Opportunities for Low-Income Parents: The Legacy of the TANF Emergency Fund," by the Center on Budget and Policy Priorities and the Center for Law and Social Policy, February 2011, http://www.cbpp.org/cms/?fa=view&id=3400.

[12] Ann Roder and Marc Elliot, "Stimulating Opportunity: An Evaluation of ARRA Funded Subsidized Employment Programs," Economic Mobility Corporation, September 2013, http://economicmobilitycorp.org/uploads/stimulating-opportunity-full-report.pdf.

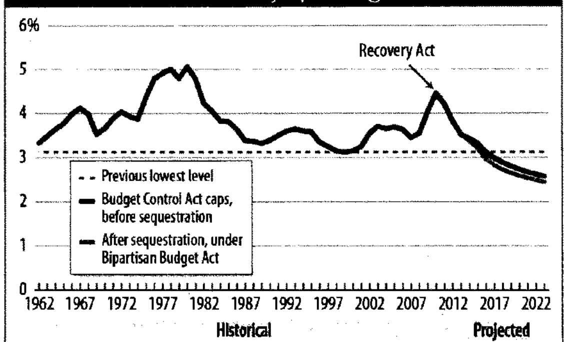
[13] Ron Haskins, "No Way Out: Dealing with the Consequences of Changes in Family Composition," Washington, DC: Brookings Institution, forthcoming.

[14] Kevin A. Hassett, Testimony Before the Joint Economic Committee, "Long-Term Unemployment: Consequences and Solutions," American Enterprise Institute, April 24, 2013,- http://www.aei.org/files/2013/04/24/-hassett-testimony-on-long-term-unemployment_155831757059.pdf.

states, support for low-income families, and important investments in the nation's economic future. As a result of the caps imposed by the Budget Control Act, spending for NDD programs is set to decline over the next decade to its lowest level on record as a share of GDP, with data going back to 1962 — even *without* the additional cuts required by sequestration. (See Figure 5.)

Figure 5

Non-Defense Discretionary Spending As Share of GDP



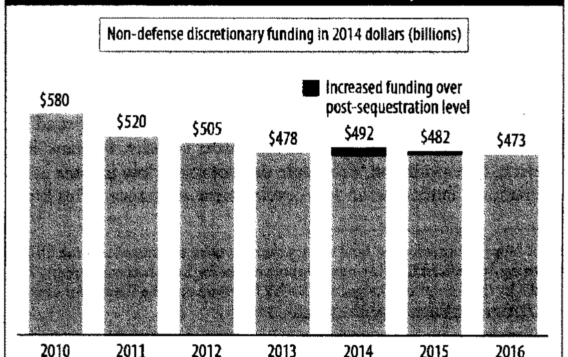

Source: Center on Budget and Policy Priorities based on Office of Management and Budget and Congressional Budget Office data.

The December budget agreement provides $45 billion of relief from sequestration in 2014, evenly divided between defense and non-defense discretionary programs. For non-defense programs, that halts a sharp downward trend in funding — which fell by nearly 18 percent between 2010 and 2013, after adjusting for inflation — and reverses a modest amount of the cuts.

But the downward trend begins again next year. After accounting for inflation, NDD funding is slated to fall in 2015 nearly back to the 2013 post-sequestration level. *By 2016, funding will have dropped below the 2013 post-sequestration level, adjusted for inflation, meaning that all of the gains from the budget agreement will be gone, and then some.* (See Figure 6).

Figure 6

Budget Agreement Provides Only Temporary Respite from Non-Defense Discretionary Cuts




Notes: 2013 figure represents Congressional Budget Office (CBO) estimate of actual funding after sequestration. All amounts exclude funding for disasters, emergencies, program integrity, and Overseas Contingency Operations.

Source: Congressional Budget Office

Further, looking only at the effects of inflation significantly *understates* the funding pressures that NDD programs will face. Many need additional funds to keep pace with population growth; grants to school districts and the administration of programs like Social Security and Medicare are just two examples. And for more than a decade, veterans' medical care has traditionally grown a much faster rate than inflation, reflecting in part the high rate of growth of health care costs in the economy.

The Pell Grant program, which is crucial to providing opportunity to children from low-income families, is a special case. Because of the way it operates, eligible students are not turned away and qualifying students receive the grant amount for which they are eligible under the program's grant schedule, as long as sufficient funds are available. Over the past few years, discretionary appropriations have been set artificially low — significantly lower than the actual cost of Pell Grants — because other legislation has provided temporary additional funding. *But that temporary funding runs out by 2016.* In that year alone, appropriations for Pell Grants will need to increase by about $6 billion, and the additional amounts needed through 2023 will be about $30 billion.[15]

Moreover, these funding increases reflect the size of individual Pell Grants under current law. While the Pell Grant maximum award rises with inflation through 2017, it is frozen thereafter at the 2017 dollar level. (The cost of indexing Pell Grants for inflation through 2017 is borne on the mandatory side of the budget and is not constrained by the tight NDD caps.) Therefore, even if the $30 billion gap in discretionary funding for the programs is somehow filled, students will still face ever-growing tuition bills with a frozen Pell Grant after 2017. If policymakers do not provide relief from sequestration for 2016 and subsequent years, either large cuts in Pell Grants will occur that place college out of reach for many aspiring children from low-income families, or else other non-defense discretionary programs will have to be cut still more deeply to close the Pell Grant funding shortfalls.

These funding problems highlight that, after the two years that the current budget deal covers, we will badly need a new budget agreement. The nation can ill afford to neglect funding for Pell Grants, elementary and secondary education, public health, environmental protection, and basic scientific research, as will occur if the funding levels required under sequestration remain in effect. Failure to make these basic investments will slow long-term economic growth — and hence make our long-term fiscal problems greater — and likely increase poverty and hardship and reduce opportunity.

These low funding levels will also undermine our ability to conduct basic government functions effectively and efficiently. The IRS budget this year is a case in point. In inflation-adjusted terms, the IRS budget has eroded steadily since 2010, even as its workload has increased. Its 2014 funding level failed to keep pace with inflation and did little to mitigate the effects of the previous year's sequestration cuts. Yet starving the IRS budget is highly counterproductive. A large part of its budget goes to curbing tax fraud, tax evasion, and other illegal activities. The Treasury estimates that every dollar spent on enforcement yields six dollars in revenue. In addition, these cuts hamper the IRS' taxpayer services. According to the National Taxpayer Advocate, because of budget cuts, "the IRS has been significantly hampered in its ability to provide 'top quality service' and maintain effective enforcement programs that minimize noncompliance."[16]

Finding the offsets to pay for needed sequestration relief will be a challenge. The recent budget agreement shows that an incremental approach, tackling more narrowly defined problems, has the

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[15] Our calculations assume that in the absence of a new budget deal providing additional relief from sequestration, discretionary appropriations for Pell Grants will grow at the same pace as the NDD caps, as reduced by scheduled sequestration from 2016 on.

[16] Taxpayer Advocate Service, "National Taxpayer Advocate 2013 Annual Report to Congress," December 31, 2013, Vol. I.

potential to succeed where broader "grand bargains" have failed. But even that deal showed the difficulty of reaching agreement when policymakers must rely entirely on cuts to programs outside the major entitlements and tax expenditures, along with user fees. Such offsets, while sometimes portrayed as "low-hanging fruit," are in fact not without controversy — as evidenced by efforts by both Republicans and Democrats to repeal the deal's modest change to military pensions, a component in the delicate balance achieved in the agreement.

The final section of this testimony returns to the issue of putting the budget on a more sustainable path, laying out some key factors policymakers should keep in mind when formulating proposals (even if such plans are unlikely to be acted on in the near future).

## III. Long-Term Fiscal Problems

If we look at how we got from where we appeared to be in 2001 — when CBO projected budget surpluses for decades to come — to where we are today, the Bush-era tax cuts, unpaid-for wars, the Medicare drug bill, and the Great Recession all played central roles.[17] At the same time, if we ask what will cause deficits to start rising again as a share of GDP at the end of the decade, the answer is that spending on Social Security, Medicare, and Medicaid — driven by rising health care costs and the aging of the population — will increase significantly as a share of GDP under current policy, while revenues will rise little. This will produce a growing fiscal imbalance and a steadily increasing debt — which, in turn, will result in steadily increasing interest costs, which then will push deficits and debt still higher.

We have long maintained that stabilizing the debt-to-GDP ratio over the coming decade is a minimum appropriate budget course. Enacting more significant deficit reduction that puts the debt ratio on a modest downward path after the economy has recovered would bring additional advantages *if* policymakers can achieve it without slowing the recovery, shortchanging important investments for the future, increasing poverty and inequality, or jeopardizing the quality of Americans' health care. Policymakers should consider creative solutions to these problems and work to lay the groundwork for developing a consensus around policies that would slow spending growth, raise more revenues, and invest in the nation's future.

As policymakers consider approaches to put the budget on a more sustainable path over the longer term, it's important to keep the following in mind:

### The Projected Rise in Spending

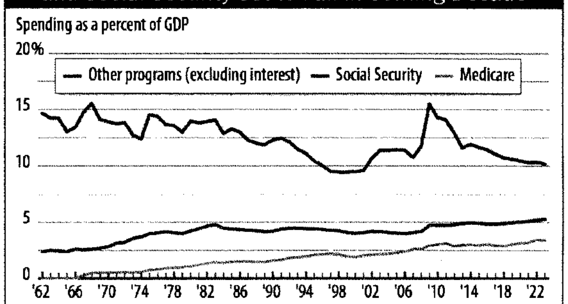
Contrary to some impressions, the rise in spending as a share of GDP projected for coming decades is not due to ***entitlements in general.*** It is concentrated in the programs affected by health care costs and population aging: Medicare, Medicaid, and Social Security.

Over the 50 years from 1963 through 2012, non-interest spending averaged 18.0 percent of GDP. Based on CBO projections, it will equal 18.8 percent of GDP in 2023 under current policy and higher levels after that. But non-interest spending ***outside Social Security and Medicare,*** which averaged

[17] Kathy Ruffing and Joel Friedman, "Economic Downturn and Legacy of Bush Policies Continue to Drive Large Deficits," Center on Budget and Policy Priorities, February 28, 2013, http://www.cbpp.org/cms/?fa=view&id=3849.

12.6 percent of GDP over the prior 50 years, is projected to equal only 10.2 percent of GDP in 2023 — significantly *below* the historical average. (See Figure 7.)

Figure 7
Non-Interest Spending Outside Medicare and Social Security Set to Fall in Coming Decade



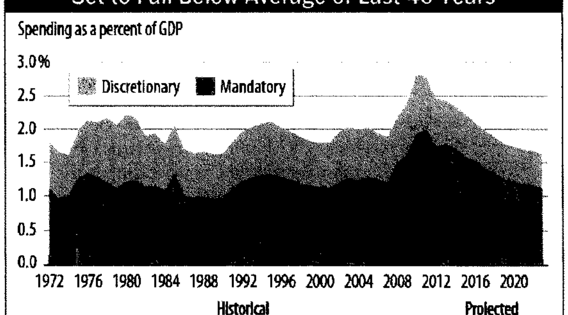

Note: program spending includes all federal expenditures other than net interest on the debt.
Source: OMB through 2012; CBPP analysis of CBO data thereafter.

This drop is due primarily to the decline in discretionary spending as share of GDP, discussed above. That said, the growth in the remaining entitlement spending outside of Social Security and Medicare is due largely to growth in Medicaid. Spending on mandatory programs other than Social Security, Medicare, and Medicaid will equal its 50-year average in 2023 (2.7 percent of GDP) and is projected to shrink somewhat as a share of GDP in subsequent decades. This means that mandatory spending outside health and Social Security isn't the driver of coming spending increases.

### Low-Income Programs

Nor are programs for low-income individuals and families outside health care the driver of coming spending increases. Means-tested entitlements (those targeted on people with incomes below prescribed levels) outside of health care averaged 1.2 percent of GDP over the past 40 years (we look back 40 years here because many of these programs didn't exist 50 years ago); they are projected to cost 1.1 percent of GDP in 2023 — a bit *below* the 40-year average — and to shrink further as a share of the economy after that. Low-income *discretionary* programs outside health care averaged 0.8 percent of GDP over past 40 years; they are expected to equal 0.5 percent of GDP in 2023 under the BCA caps, and even less if sequestration remains in place. (See Figure 8.)

Figure 8
Low-Income Expenditures Outside Healthcare Set to Fall Below Average of Last 40 Years




Source: OMB through 2012; CBPP analysis of CBO data thereafter.

The reason that some people assume means-tested entitlement costs are surging and are a significant part of the long-term fiscal problem is two-fold. First, people sometimes look at *all* means-tested programs as a group, including Medicaid. Medicaid costs have risen with health care costs generally and will grow further in the years and decades ahead because of continued increases in health costs, the aging of the population, and health reform's Medicaid expansion to shrink the ranks of the uninsured (the cost of which was offset by various deficit-reduction measures included in the Affordable Care Act).

Second, means-tested entitlements other than health care programs have indeed grown substantially in recent years, amounting to 1.7 percent of GDP in 2012, well above their historical average. But the recent increases were driven by the weak economy and the Recovery Act's temporary increases in several of these programs and will recede in the years ahead.

The above facts do *not* mean that entitlement programs other than health care programs and Social Security should be off-limits for cuts. All parts of the budget should be evaluated on their merits.

### Need for Caution When Addressing Health Care and Social Security

That Social Security, Medicare, and Medicaid are slated to rise as a share of GDP in the coming decades does not mean that long-term deficit reduction should feature deep cuts in these programs that leave would seniors, people with disabilities, families, and individuals without health care and less financially secure. With an aging population, we will inevitably need to spend somewhat more in these areas. Policymakers must be careful that changes in these programs do not leave low- and moderate-income seniors, people with disabilities, and low-income Americans poorer and in worse health.

Projected increases in per-capita health care costs will continue to put considerable pressure on federal health and retirement programs and on the budget as a whole. But there are major unknowns in the health care arena. While the growth of both public and private health costs has slowed appreciably in the past few years, experts do not agree on how much of this slowdown is likely to continue over the long term. The answer affects the size of the long-term fiscal problem and the magnitude of the measures that will be needed to further slow health-care cost growth.

More fundamentally, we currently lack needed information on how to slow health cost growth substantially without reducing health care quality or impeding access to necessary care. Demonstration projects and other experiments to find ways to do so are now starting and should generate important lessons. By later in the decade, we will know more about what works and what doesn't and how to build upon the changes already starting to slow health cost growth.

It is also worth keeping in mind that most Medicare beneficiaries aren't well off. Some 60 percent have household incomes below $30,000, and five-sixths have incomes below $50,000. That implies policymakers must take care to ensure any policy changes have adequate protection for low-income seniors. (It also helps explain why policies that seek to achieve savings solely from upper-middle and upper-income beneficiaries typically do not yield as much savings as people sometimes assume they will.)

In Medicaid, opportunities for savings that don't reduce access to care or the quality of care are quite limited at the present time. Medicaid beneficiaries are poor or near-poor, and Medicaid pays health care providers significantly less than Medicare or private insurance. Most states already use managed care for Medicaid beneficiaries who aren't elderly or disabled. As a result, Medicaid spends 20 to 30 percent less per beneficiary than private sector health coverage.

Caution is also warranted in Social Security. Changes made to shore up its financing in coming years must be designed carefully to maintain the program's critical social insurance structure and protect low- and moderate-income seniors and people with disabilities. Social Security benefits cut the elderly poverty rate (as measured by the federal government's Supplemental Poverty Measure) from 55 percent to 15 percent. This means that without Social Security, more than half of seniors would be poor.[18]

## Tax Expenditures

Ultimately, bringing down longer-term deficits and debt also will require higher revenues than are currently projected. The best place to secure them is to address tax expenditures, many (but certainly not all) of which are inefficient and do not serve a broad public purpose effectively.

Policymakers should recognize that, when tackling long-term deficits, much of the distinction between programs carried out on the spending or revenue side of the budget is essentially artificial. In many cases, there is little difference between benefits or subsidies provided through the tax code and those provided through spending programs.

Education is one example. On the spending side of the budget, the federal government provides Pell Grants to help low- and moderate-income students afford college. On the tax side of the budget, so-called 529 accounts help parents pay for college by providing tax subsidies that are most generous for upper-income households. Both of these policies are government subsidies to promote higher education; the tax/spending distinction is not meaningful here.

Child care provides another example of why tax expenditures generally are the equivalent of spending programs and essentially operate as entitlements. Low- and moderate-income working families with federal child care subsidies receive them through spending programs, such as the Child Care and Development Block Grant (CCDBG). CCDBG funding is capped, so it serves only as many low-income families as its funding allows. As a result, only about *one in six* low-income working families with children that meet the qualifications for a federal child care subsidy actually receives one. Middle- and upper-income families with federal child care subsidies get them through the tax code, through the Dependent Care Tax Credit (DCTC). Unlike CCDBG, the DCTC has no cap on its cost, so any tax filer who qualifies can receive the credit. This tax-based subsidy for middle- and upper-income families thus operates as an open-ended entitlement, unlike the child care subsidies delivered through spending programs to low- and moderate-income families.

Efforts to reduce spending should therefore also address spending in the tax code. Harvard economist (and former chief economic advisor to Ronald Reagan) Martin Feldstein has written that "cutting tax expenditures is really the best way to reduce government spending," while former

[18] This figure shows that a large share of seniors have only modest income other than Social Security. If Social Security did not exist, many elderly individuals likely would have saved somewhat more and worked somewhat longer, and many might live with their adult children rather than in their own households. Studies confirm however, that Social Security has reduced poverty dramatically.

Federal Reserve Board Chair Alan Greenspan has referred to tax expenditures as "tax entitlements" and said they should be looked at alongside spending entitlements.

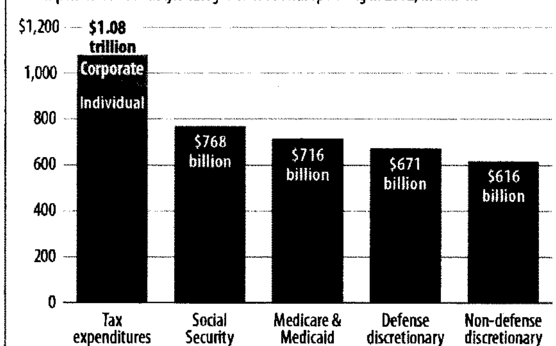
There is also an equity issue here. "Spending" entitlements provide most of their benefits to middle- and lower-income households, while tax-expenditure benefits — or "tax entitlements" — go heavily to high-income households. Specifically, the distribution of federal entitlement expenditures tracks fairly closely to the distribution of the population — nearly 60 percent of their benefits go to the middle 60 percent of the population, and about 30 percent go to the bottom fifth. In contrast, tax expenditure benefits are skewed much more to the top of the income spectrum, with the top fifth receiving over half of the benefits and the top 1 percent receiving 17 percent, while the bottom fifth receives only about 8 percent of the tax expenditure benefits.

If policymakers exempt tax expenditures from deficit reduction, that will likely place the onus of further deficit reduction entirely on spending programs, and almost certainly result in regressive outcomes that further widen income disparities and magnify poverty.

Figure 9

Tax Expenditures Are Very Costly

Tax expenditures and major categories of federal spending in 2012, in billions




Notes: Tax expenditure estimates do not account for interaction effects; estimate does not include associated outlays ($94 billion) or the effects on excise and payroll receipts ($112 billion).

Source: Office of Management and Budget, Historical Tables 8.5 and 8.7 and Analytical Perspectives Table 16-2.

Tax expenditures are costly, reducing revenues by over $1 trillion annually, and often are poorly designed for achieving their desired policy goals. (See Figure 9.) Some would prefer to use all savings from tax expenditure reform to cut tax rates without shrinking deficits, but that would be ill-advised. The current political environment remains inhospitable to a new tax such as a carbon or a value-added tax and, after the "fiscal cliff" deal, further tax-rate increases. This leaves only tax expenditures as a politically plausible source for a meaningful revenue contribution to deficit reduction to accompany reductions in certain programs.

Chairman MURRAY. Thank you, Mr. Greenstein.

Dr. Zandi, welcome. We will turn to you.

**STATEMENT OF MARK ZANDI, PH.D., CHIEF ECONOMIST, MOODY'S ANALYTICS**

Mr. ZANDI. Sorry I am late. A lot of snow in Pennsylvania.

Chairman MURRAY. We are glad it is not here.

Mr. ZANDI. Yes, more than I would have expected.

Well, thank you for the opportunity to be here this morning. I have three points I would like to make in my opening remarks. I do have slides if someone wants to power that up. I will just use one or two of them.

The first point is I am optimistic about the economy's near-term prospects. In terms of GDP, the value of all the things that we produce, we have been growing roughly 2 percent per annum, a little over that, since the recovery began 4–1/2 years ago. I expect growth this year of 3 percent and closer to 4 percent in 2015.

There are a number of reasons for this optimism. The most important is the fiscal drag is fading. We have been through a period of very significant fiscal austerity—Government spending cuts, tax increases. If you add it all up, it shaved 1–1/2 percentage points from GDP growth in calendar year 2013. So the economy grew 2 percent. If fiscal policy was simply neutral with respect to the economy, the economy would have grown 3–1/2 percentage points last year. By the way, that is growth in the private economy. The private economy grew 3–1/2 percentage points last year.

This year under current law, assuming no change in law, the fiscal drag will be no more than half a percentage point, probably a little less than that. So we are going to get a point to growth simply because the austerity is less significant this year compared to last. And that is arithmetic and a very solid reason for optimism. Next year the drag will be a couple three-tenths of a percentage point, and in 2016 it will be zero. So this is a very important reason for optimism.

Another reason for optimism is more fundamental; that is, the economy has come a long way in righting the wrongs that got us into the Great Recession. We have de-levered. We have reduced debt. Businesses have reduced their cost structures significantly. Households in aggregate have their debt loads down. The banking system is much better capitalized. This is, most of it, with regard to American businesses, they are very competitive. Unit labor costs, which is a good measure of international competitiveness, have not changed—that is labor compensation per unit of output, so it counts for productivity growth—essentially in almost 10 years. And in manufacturing, which is obviously where the competition is most fierce globally, it has not changed in almost 25 years. And given the very positive energy story, I think prospects are very good for American companies. They are in very good shape and should be able to produce more jobs going forward.

The one missing ingredient to stronger growth, though, throughout the economic recovery has been confidence. There have been a lot of factors weighing on sentiment. Most significantly has been the budget wars here in Washington. They have been very debilitating psychologically. The good news is, I think we are past the worst of that, and I think you can see it already in the confidence measures. Various surveys show much improved confidence, and I think that is going to start translating into more aggressive business hiring, so that means more jobs and more investment, and that augurs very well going forward. So I am optimistic.

Point number two, things can go wrong. There are threats to my optimism. You can see that in the marketplace today, the last few days. I think the most significant threat is a policy error. Most significantly, most immediately is lawmakers must raise the Treasury debt limit quickly. By my calculation, the drop-dead date is probably March 3rd, large Social Security payment on that day. There probably will not be enough cash in the Treasury to make full payment, so the debt limit has to be increased.

I would also argue that there are a number of other things policymakers could do to support the economy near term. I strongly agree with Mr. Greenstein that we should extend the emergency unemployment insurance program, expand the earned income tax credit for childless workers, and increase the minimum wage modestly. I think those would be very important boosts to the economy near term.

Finally, my third point, while the fiscal situation through the remainder of this decade is stable, it looks okay, obviously in the longer run we have got problems. That requires then that lawmakers will need to do more work. We do need entitlement reform. We do need tax reform. We do not need it today. We do not need it next year. But we certainly will need it before the end of the decade because we will have very significant problems as we move into the next decade if we have not addressed these things. And along the way, it would be very helpful if we could do things that would spur strong economic growth, no better way to address our long-term fiscal problems. So we should be focusing on policy that helps to lift the supply side of the economy, more infrastructure spending—I can testify to that today. Being stuck on an Amtrak train for a half-hour, I am all for more infrastructure spending, and I would be willing to pay for it myself. More funding for early childhood education, evidence there is quite strong; and immigration reform. All those things I think would be quite helpful for the economy in the longer run and help our long-term fiscal situation.

Thank you very much.

[The prepared statement of Mr. Zandi follows:]

Written Testimony of Mark Zandi
Chief Economist, Moody's Analytics

Before the Senate Budget Committee

*"The 2014 Outlook: Moving From Constant Crises to Broad-Based Growth"*

February 4, 2014

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The U.S. economy is set to experience stronger and broader growth as the middle of the decade approaches. Underpinning this optimism are the private economy's much-improved fundamentals: Businesses are highly profitable and very competitive, households have reduced debt burdens and are saving more, and the banking system is well-capitalized and liquid.

Housing, which had been at the center of the economy's problems, is expected to add significantly to growth. As has been the case since the housing crash, homes are being built too slowly to meet the demand generated by demographic trends. More and more housing markets across the country are going from overbuilt to undersupplied.

Also supporting stronger growth is the fading of fiscal austerity. Government spending cuts and tax increases have been a powerful headwind to the economy in recent years. Not since the defense drawdown after the Korean War has the economy been affected on this scale by federal action, but this headwind will diminish quickly as fiscal policy stabilizes.

The key missing ingredient for stronger growth has been confidence. Businesses have been reluctant to take the leaps of faith that historically have been common by this point in past recoveries to expand operations. Hiring and investment have been lackluster. This is changing, however, as businesses appear to be finally getting back on track. Various surveys of large and small firms show sentiment meaningfully improved since lawmakers reopened the federal government last fall and reached a budget deal that eased political tensions in Washington.

Real GDP is expected to accelerate from the disappointing 2% growth pace that has prevailed throughout the recovery to 3% this year. Growth in 2015 is expected to accelerate further to a robust rate approaching 4%. At this pace, the economy is on track to reach full employment by late 2016.[i]

A number of threats could change this upbeat outlook, however. Political brinkmanship over the Treasury debt limit, which must be increased in the next few weeks, and the winding down of the Fed's bond-buying program are immediate worries. Global threats, from turmoil in emerging markets to a renewed euro zone crisis, are serious. Political pressures put the Middle East and Asia in constant danger of boiling over.

The economy also faces daunting long-term challenges. The federal government's near-term fiscal outlook is stable, but the nation's debt load is uncomfortably high, and unless policymakers come to terms on entitlement and tax reform soon, deficits and debt will balloon early in the next decade.

The American Dream could fade unless the increasingly skewed distribution of income and wealth is addressed. Forces driving inequality, including technological change and globalization, are firmly in place. Near term, policies such as extending emergency unemployment insurance, expanding the Earned Income Tax Credit, and raising the minimum wage would help. Longer term, policy should focus on raising educational attainment, increasing worker training, reforming immigration laws, developing infrastructure, and lowering political and social barriers to income mobility.

But while the path will not be straight up and significant hurdles remain, the U.S. economy's prospects are brighter than they have been in years.

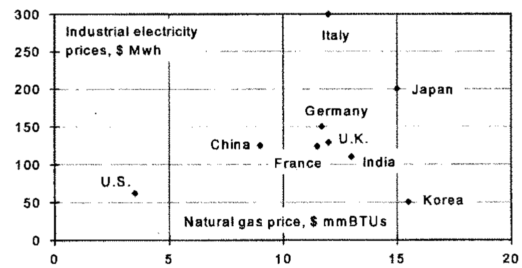
**Flush businesses**

A necessary condition for sustainably strong economic expansion is a solid private sector balance sheet. The economic wrongs that precipitated the Great Recession have been largely righted. Leverage is low and the economy is bubble-free. Businesses and households have significantly reduced their debt loads and the financial system is well-capitalized. And while stock and house prices have risen strongly over the past two years, they appear to be still in line with corporate profits, household incomes and rents.

The financial health of nonfinancial businesses has arguably never been better. Corporate profit margins are almost double their long-term average, as businesses have significantly reduced cost structures.[ii] Unit labor costs—compensation measured in relation to productivity—have barely budged since the recession. In manufacturing, labor costs are about where they were a quarter century ago.

Manufacturers are also receiving a lift from the surge in oil and natural gas production and the resulting lower prices. U.S. natural gas prices are likely to remain well below global levels for the foreseeable future, as exporting natural gas will be difficult and there are limited uses for it in the transportation system. Since natural gas is an increasingly important energy source for utilities, electricity prices will also remain low compared with those of the rest of the world (see Chart 1).

**Chart 1: U.S.'s Energy Advantage**




Sources: Country sources, Moody's Analytics

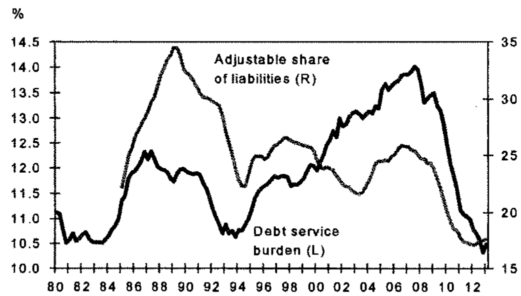
Businesses have also done a good job shoring up their balance sheets, as debt service is low and they are awash in cash. The quick ratio—comparing cash and other short-term assets to short-term liabilities— for nonfinancial companies has never been as high.[iii] Businesses' large cash hoard is a barometer of their skittishness about taking risks and expanding their operations, but it also signals they have the financial resources necessary to do so whenever they feel sufficiently comfortable.

Firms have locked in record low interest rates. Corporate bond issuance has soared since the recession as corporate bond rates have plunged. The rate on Baa corporate bonds (the lowest investment grade) has hovered near 5% for the past two years, marking the lowest borrowing costs since the 1940s. Rates on below-investment grade corporate bonds have never been as low.[iv]

**Working down debt**

Households have significantly reduced their debt burdens. The share of after-tax income needed to remain current on their payments is as low as it has been since at least 1980 (see Chart 2). This is due to both rock-bottom borrowing costs and more than a 10% reduction in the amount of debt owed.[v] That reduction was driven by a rise in mortgage defaults, which, while not an ideal way to resolve a financial imbalance, was therapeutic. Originations of mortgages and credit cards have also been weak.[vi]

**Chart 2: Households Deleverage and Lock In**




Sources: Federal Reserve, BEA, Moody's Analytics

Lighter debt burdens combined with lower unemployment are causing a rapid improvement in credit quality. According to Equifax, the dollar delinquency rate on all household liabilities is approaching 4%, down from a peak of 8%, and not far from the 3% rate that prevails in the best of times. Credit card, auto, and consumer finance loan delinquencies are already as low as they have ever been.

The household deleveraging process, which place significant constraints on consumer spending and growth, is over. Originations are picking up and household credit growth has turned positive. Like businesses, households are well-positioned for any increase in interest rates, since a refinancing boom in recent years has allowed them to lock in low rates. Only a fifth of household liabilities are now tied to rates that adjust from year to year.[vii]

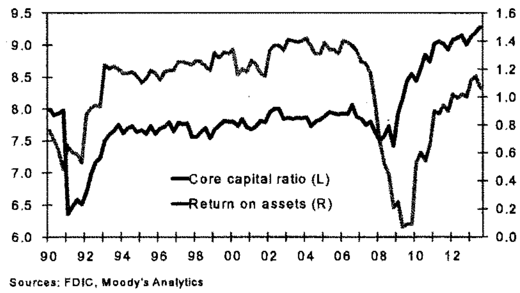
Some problems remain. More than 2 million first-mortgage loans are in or near foreclosure, and a rising number of home equity loans are approaching payment resets. But rising house prices make these problems manageable. Rapidly rising student loan debt is also a worry, but not on a scale that will threaten the broader recovery.

**Capital-rich banks**

The banking system is well-capitalized and highly liquid. Banks are holding high-quality Tier-1 capital equal to more than 9% of their assets. This compares with an average capital-to-asset ratio just over 7% since the FDIC was established in the 1930s (see Chart 3). With credit losses continuing to decline and net interest margins widening as the yield curve steepens, banks' profitability and capital levels should continue to improve.

**Chart 3: Well-Capitalized and Profitable Banks**

Commercial banks




Sources: FDIC, Moody's Analytics

To make absolutely sure that the banking system has sufficient capital, the nation's largest banks are required to stress-test their balance sheets and income statements every year, showing they can withstand the darkest of economic scenarios.[viii] The current round of stress tests envisages an economic downturn at least as severe as the Great Recession. The tests also require banks to prepare for a rapidly rising interest rate environment, just in case the Federal Reserve is unable to gracefully unwind its bond-buying and zero interest rate policies.

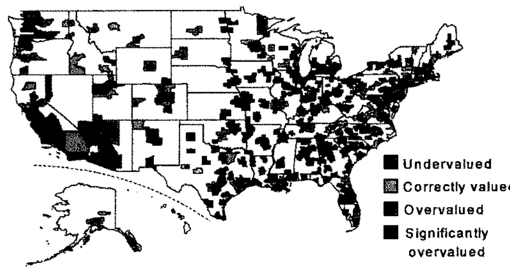
With sturdy balance sheets, banks now look to make more loans. They have eased underwriting standards for commercial and industrial, real estate and consumer loans.[ix] Standards for residential mortgage loans are still tight, but this should change in coming months given improving credit quality, the end of the refinancing boom, and increased clarity about various regulatory and legal issues that have bedeviled lenders. Net loans and leases at commercial banks are expanding at a solid mid-single digit pace.

**Bubble free**

Stock and house prices have been on a tear. Despite the recent correction, stock indexes are near record highs, up an astounding 30% last year and almost 50% over the past two years. House prices, as measured by Case-Shiller indexes, are up almost 15% over the past year and 20% over the past two. Surging asset prices have lifted household wealth and supported consumer and business confidence, providing a vital tailwind to the recovery.

Despite these gains, however, stocks and housing appear appropriately valued. There is no indication that speculation and leverage have produced bubbles in either stocks or housing. Equity prices are being supported by record corporate earnings, putting price-earnings ratios for the major indexes not far from their long-run averages. House prices still appear low by historical standards relative to household incomes and only slightly high compared with effective rents (see Chart 4).[x]

**Chart 4: Most Housing Is Appropriately Valued**
2013Q3




Sources: CoreLogic, BEA, PPR, Moody's Analytics

To be sure, stock and house prices have been pumped up by the Federal Reserve's bond-buying program.[xi] Corporate bond yields, which are important to stock valuation, and fixed mortgage rates are an estimated 100 to 150 basis points lower than they would have been if the Fed had not engaged in quantitative easing. The lower interest rates have in turn increased stock prices 10% to 15% and house prices as much as 5%.

As the Fed normalizes monetary policy, this will put downward pressure on asset valuations and prices. The Fed has said this process will occur over several years, however, suggesting that the impact on stock and bond prices will be drawn out and not acute.

**Housing recovery**

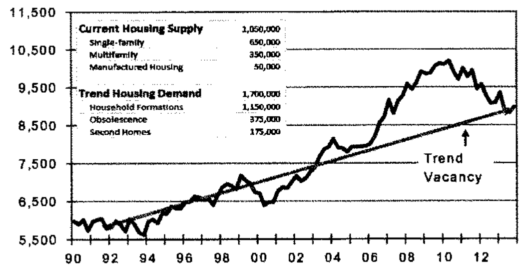
The recovery in the housing market augurs well for the broader economy. While housing has come a long way since hitting bottom two years ago, home sales and construction remain low given demographic needs.

This is clearest with regard to homebuilding. Builders are constructing new single- and multifamily homes and manufactured housing at a pace of just over 1 million units per year. Across the business cycle, demand for new housing units is estimated at 1.7 million units. This trend demand is composed of 1.15 million new household formations, 375,000 replacement structures and 175,000 second and vacation homes.[xii]

Recent demand for new homes has run well below that trend, but homebuilding has been even weaker. The number of vacant homes is thus falling rapidly, and what was a significantly overbuilt housing market just a few years ago will soon be undersupplied (see Chart 5).

**Chart 5: Housing Will Soon Be Undersupplied...**

Vacant homes for sale, for rent, and held off market, ths




Sources: Census Bureau, Moody's Analytics

Homebuilding is thus set to ramp up significantly over the next several years. Activity may even be supercharged for a time given prospects for a period of very strong household formation. Many twentysomethings have been unable to find jobs in recent years and continue to live with their parents. The number of U.S. households with adult children at home is up by more than 1.5 million since the Great Recession. Once the job market picks up, many of these young people will strike out on their own, fueling demand for new homes. This has already begun as demand for multifamily rental units that cater to younger people is robust.

The housing recovery is vital to the job market. Every newly built single-family home supports nearly four new jobs over one year in construction, manufacturing, transportation, retailing and financial services.[xiii] Every new multifamily unit supports closer to two new jobs over a year. If homebuilding simply increases from the current pace of 1 million units to its trend rate of 1.7 million, at least two million new jobs will be created (700,000 additional housing units multiplied by an average three jobs per unit). This by itself will reduce the unemployment rate by 1.25 percentage points.

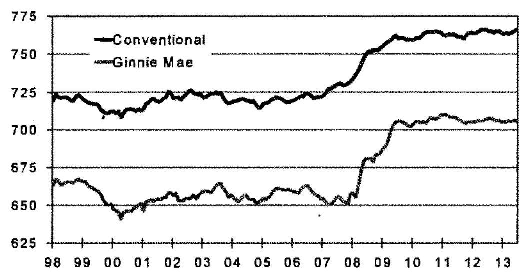
While housing's demographic underpinnings are strong, the pace of recovery faces some threats. Investor demand for homes has weakened over the past year. Investors had been buying up distressed properties, attracted by low prices and strong rental demand coming out of the housing bust. But with fewer remaining distressed properties, higher house prices and easing rental demand, single-family housing is no longer such a compelling investment.

For the housing recovery to continue, first-time and trade-up homebuyers must fill the void left by investors. Last summer's surge in interest rates complicated this transition. Fixed-rate mortgages jumped from a nearly record low below 3.5% in the spring to more than 4.5% by the fall. While these rates are still low by historical standards, the rise, combined with double-digit price gains in many markets made single-family housing much less affordable. Potential homebuyers suffered sticker shock.

Potential first-time homebuyers also face exceedingly tight mortgage credit. All but those with the strongest balance sheets find it difficult to obtain loans. The average credit score among those receiving home purchase loans this year exceeds 750, some 50 points higher than the average score for all households and 50 points higher than the average among those receiving home purchase loans a decade ago, before the bubble (see Chart 6).

**Chart 6... Mortgage Underwriting Is Tight**

Average credit score for purchase loans at origination




Sources: CoreLogic, Moody's Analytics

A number of mutually reinforcing factors are making credit tight. Lenders have reassessed how much risk they are willing to take on, both in reaction to losses suffered in the collapse and because they now recognize costs associated with riskier lending that were not fully appreciated before. These include the cost of servicing distressed borrowers and the reputational and legal risks associated with servicing significant numbers of delinquent or defaulting loans.

Lenders also worry that Fannie Mae, Freddie Mac, or the Federal Housing Administration will force them to take back loans sold to these agencies because of mistakes in underwriting. All three agencies grew more aggressive about putting defaulting loans back to lenders in the wake of the housing collapse. Along with uncertainty about the rules they must follow to avoid such "put-backs," this leaves lenders willing to make only very high-quality loans with little prospect of default.

Despite the threats, housing is expected to get back on track by spring. Fixed mortgage rates have recently fallen toward 4.25%, and mortgage standards appear to be slowly easing as lenders become more confident in the recovery and work through their issues with Fannie Mae, Freddie Mac and the FHA. Assuming the Federal Reserve is able to manage future interest-rate increases so they are consistent with an improving job market, housing will be an important contributor to the economy's growth. Housing activity will not be dented by higher mortgage rates if there are plenty of jobs lifting homebuyers' purchasing power and confidence.

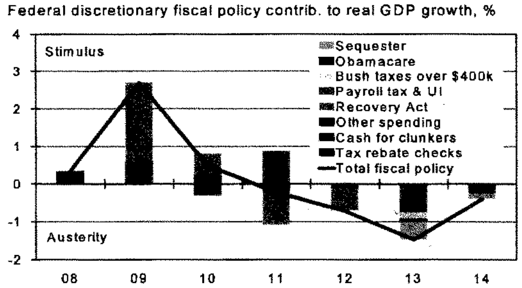
**Fading fiscal austerity**

Economic growth will also be significantly boosted as fiscal austerity fades. The hit to real GDP growth last year due to federal government spending cuts and tax increases is estimated at 1.5 percentage points. In other words, if federal fiscal policy had been simply neutral with respect to the economy, neither adding to nor subtracting from growth, the economy would have grown 3.4% in 2013. Since state and local government policy was neutral with respect to the economy, this was the growth rate in the private sector.

If policymakers make no further changes to spending and tax policy, the economic drag from fiscal policy will fade to no more than 0.4 percentage point this year, and the drag in 2015 and 2016 will be minimal (see Chart 7). The budget deal signed into law at the end of 2013 appears to rule out further significant changes to fiscal policy for the foreseeable future.[xiv] The accord, which did away with the across-the-board sequester cuts, set federal government spending levels for two years.

**Chart 7: Fiscal Austerity Peaks**

Federal discretionary fiscal policy contrib. to real GDP growth, %

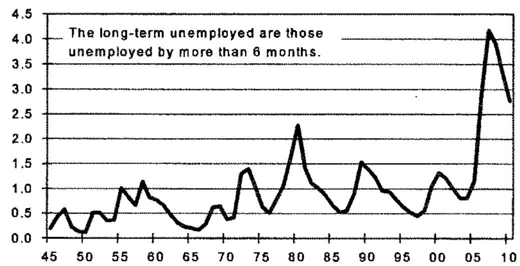



Source: Moody's Analytics

The fiscal drag this year would be even less if lawmakers would extend the emergency unemployment insurance program. It would be unprecedented not to extend the program given the still very high unemployment rate. The 6.7% rate recorded for December is near the average peak in recessions since World War II, to which emergency UI has typically been part of the policy response (see Chart 8). An extension of the program would reduce the fiscal drag on real GDP growth in 2014 by an amount between 0.15 and 0.25 percentage point.

**Chart 8: Ending Emergency UI Would Be Unprecedente**

Long-term unemployed as a % of labor force




Sources: BLS, Moody's Analytics

One side effect of not extending the emergency UI program would be a drop in the unemployment rate by an estimated 0.25 percentage point in the next few months. But this would result from increased retirements by older unemployed workers, who will leave the workforce once they stop receiving UI benefits, exacerbating the recent decline in labor force participation.

**In the groove**

The main missing ingredient for stronger growth has been confidence. The nightmare of the Great Recession has weighed heavily on the collective psyche, and confidence has been rocked throughout the recovery by a string of debilitating shocks that were all but impossible to handicap. Most notable among these are the on-again, off-again European debt crisis and Washington's incessant political brinkmanship.

The uncertainty created by budget battles in Congress has been a serious constraint on growth through the economic recovery. A statistical analysis shows that increased political uncertainty from 2008 through 2013 (and thus including the government shutdown at the end of last year) lowered real GDP by $170 billion, reduced employment by 1.2 million jobs, and raised the unemployment rate by 0.75 percentage point.[xv]

The budget deal achieved at the end of 2013 was thus very encouraging. It appears to have effectively ended the bitter bipartisan warfare over spending and taxes that twice brought the nation to the brink of debt default. Political tension and uncertainty have eased, and sentiment has improved.

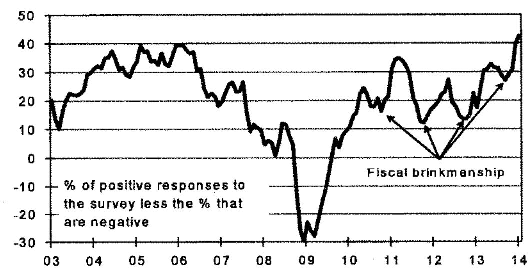
The growing optimism has been clearest in financial markets, with stock prices near record highs and corporate credit spreads tightening as bond investors demand a smaller risk premium to buy businesses' debt. The price of gold, the ultimate safe-haven investment, fell sharply last year.[xvi]

Consumers are not as cheerful, particularly those in lower-income households that do not benefit from rising stock and house prices. Yet even here optimism is increasing. Consumer sentiment falls each time federal lawmakers become embroiled in another budget battle. Encouragingly, however, confidence has rebounded quickly since the latest standoff and is now as high as it has been since before the recession.

Perhaps most importantly, businesses are much more upbeat. At the start of 2014, sentiment is as strong as it has been in the 11-year history of the Moody's Analytics weekly survey (see Chart 9). More than half the responses to the nine questions posed in the survey are positive, compared with the average of closer to one-third since the survey began. Only 10% of responses are negative.

**Chart 9: Businesses Get Their Groove Back**

U.S. business confidence diffusion index




Source: Moody's Analytics

Expectations regarding the economy's outlook through the first half of 2014 are notably cheery. Close to three-fourths of respondents say conditions will improve further during the first half of this year. Expectations are stronger than assessments of current economic conditions, generally a positive leading indicator for growth and consistent with the view that the economy will accelerate.

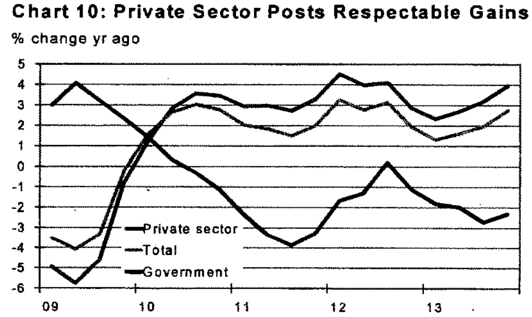
**Secular stagnation?**

The tough economy has engendered fears that something fundamental is amiss—that since the late 1980s periods of strong growth and full employment have occurred only when powered by speculation and asset bubbles. Of course the bubbles eventually burst, pushing the economy into increasingly severe downturns and high unemployment. Under this view the economy's longer-term path is characterized by secular stagnation. [xvii]

In this perspective, the economy achieved full employment in the late 1980s only because of a bubble in commercial real estate, powered by an out-of-control savings and loan industry. Full employment in the late 1990s grew out of the stock market's technology bubble, and the housing bubble was necessary to achieve full employment in the mid-2000s.

Such pessimism is misplaced. Yes, growth in the current recovery has been disappointing, but mostly because of fiscal austerity. The private economy has posted very respectable gains, expanding at a 3.3% annualized pace.[xviii] In 2013, private sector growth was robust at almost 4% (see Chart 10).[xix] And this happened while businesses and households were shrinking debt and asset markets have remained bubble-free. With fiscal austerity fading, a stronger private economy will become evident.

**Chart 10: Private Sector Posts Respectable Gains**



Sources: BEA, Moody's Analytics

Bubbles and financial crises have been a fixture of the U.S. economy since its inception. The near collapse of the financial system in 2008-2009 produced the most severe downturn since the 1930s. However, the Great Recession was due not to inherent weakness in the economy, but rather to policy missteps and to idiosyncratic problems that have more or less been addressed.[xx] This is not to say there will not be financial crises in future, when the financial system is overflowing with euphoria and most investors feel nothing can go wrong. Mistakes will surely be made.

The secular-stagnation hypothesis will soon be tested. If businesses remain cautious and fail to increase hiring and investment, it would lend support to that gloomy perspective. But if businesses' animal spirits are unleashed by the end of Washington's budget wars and greater clarity around reforms of the financial and healthcare systems, stagnation will seem to be only a passing cloud.

Economic growth will be slower in coming decades than in past decades, but because of well-anticipated demographic changes that will slow growth in the labor force. Baby-boom retirements are accelerating, and foreign immigration has slowed, reflecting better economic conditions in the emerging world and lower fertility rates.[xxi]

**Policy missteps**

The principal threat to stronger U.S. economic growth this year is a policy mistake. Most immediately, Congress must raise the Treasury debt limit again. The Treasury's borrowing authority runs out in the next few days, and while it will use various extraordinary measures to continue paying its bills, it will run out of options by early March given that cash needs grow to pay tax refunds.

Given the political fallout from last fall's budget battle, chances are lawmakers will come to terms before they do significant damage to confidence and the economy. But given Congress' past behavior, more political brinkmanship and even a breach of the debt limit cannot be completely ruled out.

The Federal Reserve must also gracefully manage interest rates higher consistent with an improving job market.[xxii] This will require winding down its bond-buying program and normalizing short-term interest rates as unemployment declines and the economy reaches full employment. Getting this right will be tricky: An undesirable surge in long-term rates last summer was triggered when Fed officials merely began to talk about slowing the pace of asset purchases. Investors seemed to assume that tapering meant the Fed would begin raising short-term rates soon after quantitative easing ended.

The Fed does appear to have convinced bond investors, at least for now, that it has no plans to raise short-term rates soon. Long-term rates are starting the year roughly where policymakers want them. If rates again start to rise too quickly for comfort, policymakers can respond using a range of tools.[xxiii] Nonetheless, the Fed faces a difficult task, and mistakes are possible.

**Emerging-market threat**

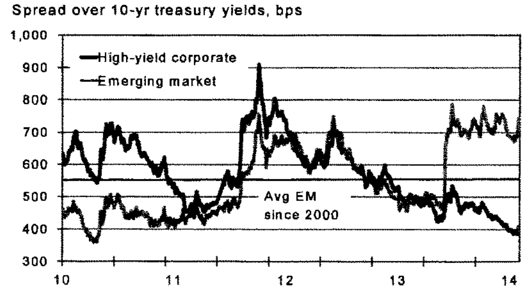
Other meaningful threats to stronger U.S. economic growth come from overseas. Financial turmoil, weak growth and simmering political unrest in the emerging world are most worrisome. Emerging-market economies have powered global growth for more than a decade and account for more than one-half of global GDP. But while growth continues in the emerging world, it is falling well short of expectations, fomenting tensions that boiled over this past year in Brazil, Egypt, Thailand and Turkey. Argentina, China, India and Russia have also experienced greater strife.

Part of the problem is that the outsize growth of emerging markets has been fueled by excess credit growth and speculation. Quantitative easing by central banks in the developed world has exacerbated this, as liquidity-flush global investors have piled into emerging-market investments. The other part of the problem is that policymakers in developing economies have not been especially adept at addressing these excesses. China's on-again, off-again efforts to rein in rapid credit growth, and Brazil's botched attempts at managing hot-money flows into its financial markets are testimonial to this.

These stumbles come at a time when an expanding middle class in the developing world desperately wants more economic and political freedom. A taste of both has left people increasingly frustrated at their political elites' inability to deliver more. Endemic corruption is making matters worse. Some demonstrations have turned violent, causing global investors to grow skittish—yields on emerging-market debt have widened considerably relative to Treasuries—weighing further on growth (see Chart 11).

**Chart 11: Emerging Economies Struggle With Tapering**

Spread over 10-yr treasury yields, bps




Sources: Bloomberg, Treasury, Moody's Analytics

So far, there has not been much fallout from this on the U.S. economy. Oil and other commodity prices are stable and U.S. export growth is slow but firm. However, a more serious faltering among emerging markets, especially in China, would be difficult for the global economy to absorb.

Tensions in the Middle East also threaten to be an economic drain. The wars in Iraq and Afghanistan have been extraordinarily costly, and the Syrian civil war and the military coup in Egypt are the latest worries. Mounting acrimony between Shia and Sunni Muslims more broadly, fueled in part by funding from Shia Iran and Sunni Saudi Arabia, could cause unrest to escalate. If oil production in the region is disrupted, it would quickly become a serious global economic problem.

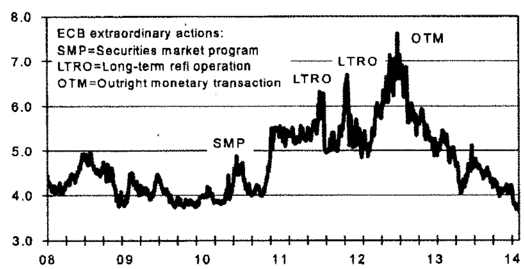
The U.S. is less sensitive than it once was to swings in energy prices, thanks to the growth in domestic shale oil and natural gas production. But it would still hurt a lot if global energy prices spike.

**The euro zone's travails**

The euro zone crisis was dormant last year as the European Central Bank's aggressive actions convinced investors the currency union would remain intact. Most important was the announcement of the ECB's Outright Monetary Transactions program at the end of 2012, which permits it to purchase the debt of troubled sovereigns. The ECB has not been forced to use the OMT, but the mere fact that it can has settled bond yields. Italian and Spanish 10-year bonds, for example, carry very manageable yields below 4% (see Chart 12).

**Chart 12: Euro Zone Hangs Together**

Spanish 10-yr sovereign yields




Sources: Bloomberg, Moody's Analytics

With the odds of a euro zone crackup fading, financial markets have rallied, confidence has improved, and the region's recession has ended. Germany's economy is enjoying solid growth, and even those of countries on the euro zone periphery are more stable. France and Italy are the most disappointing, as those countries have been slow to adopt structural reforms, and thus their economies are increasingly uncompetitive.

The euro zone is expected to grow enough this year to stem the rise in unemployment. This is critical, since political fissures evident across the single-currency region could easily widen with unemployment above 12%, and the jobless rate among younger workers approximately doubles that. Politics appears especially dysfunctional and fragile in Italy, France, Greece, Portugal and Spain.

A key test of whether the zone's recovery is sustainable will be this year's European bank stress tests. These are part of the zone's efforts to better integrate its banking system and revive the flow of credit. Bank lending to households and businesses is declining, particularly on the periphery where lending rates are much higher, because of uncertainty about banks' financial stability. This is not consistent with continued growth. By engaging in truly stressful stress tests that require undercapitalized banks to raise sufficient equity, the hope is lending rates will decline and credit will flow more normally.

For the stress tests to succeed, however, it is necessary that European policymakers define a clear resolution mechanism for banks that are unable to raise capital, and to have a sufficiently large bailout fund backed by the zone's sovereigns to help too-big-to-fail institutions if they need capital and are unable to raise it from private investors. There has been progress, but it is unclear whether it is enough for the testing to work. If the process fails, the euro zone's recovery could be stillborn.

Another developing concern for the euro zone is disinflation. A regional core inflation rates below 1% means that some countries are suffering outright deflation. Falling prices crimp demand as consumers put off purchases, waiting for prices to drop further, and increase pressure on debtors suffering weaker wages and profits. Sovereign debt loads also continue to rise despite significant fiscal austerity as nominal GDP declines.

Pressure on the ECB to respond to mounting deflation is growing. Compared with the Fed, the Bank of England and Bank of Japan, the ECB has been much slower to reduce interest rates and expand its balance sheet. This is one reason why the euro's dollar exchange rate is above $1.35, well above its long-run equilibrium nearer $1.20. The high currency value has been manageable for the very competitive German economy, but painful for the rest of Europe.

Until the ECB adopts a more aggressive monetary stance, the euro zone will struggle with uncomfortably low inflation, an overvalued euro, and weak or nonexistent growth. There is a risk that the euro zone growth will falter in 2014, precipitating another round of financial turmoil. While this likely would not be enough to upend the U.S. recovery, it could be enough to short-circuit stronger growth once again.

**Forecasting with a ruler**

Economists have a tendency to forecast with a ruler, assuming the economy's recent performance will continue into the future. Many such forecasts were issued in the last decade, assuming the "great moderation" meant the good times would never end.

Similarly, straight-edge adherents now conclude that the difficult times that have occurred since the recession are here to stay. This view holds that it will take years to return to full employment and that growth will be much slower than we want for the foreseeable future—that secular stagnation is the new normal.

Forecasting with a ruler is inevitably wrong, however, and this will become evident again in 2014. While the coming year could see another false start, the greater likelihood is that the U.S. recovery will finally evolve into a full-blown, self-sustaining expansion. The fundamentals are as good as they have been for decades, and it is increasingly difficult to envisage shocks that could undermine them. Worries exist, including economic and political stumbles in the emerging world, Europe's travails, and the possibility of botched fiscal and monetary policy in Washington. But these threats do not feel as existential as those the economy has been grappling with since the recession.

The U.S. economy should have a breakout year in 2014.

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[i] Full employment is defined as a 5.7% unemployment rate and a nearly 64% labor force participation rate. As of December 2013, unemployment is 6.7% and labor force participation is 62.8%.
[ii] The after-tax corporate profit margin rose to 19.6% in the third quarter of 2013 according to the BEA. The average since World War II is 11.1%.
[iii] The quick ratio is currently 50%, according to the Federal Reserve's financial accounts (formerly known as the Flow of Funds). The average quick ratio since World War II is 35%.
[iv] The yield on corporate junk bonds is currently near 7%, 400 basis points over 10-year Treasury yields. The average spread since the 1980s is closer to 500 basis points. Covenants on junk bonds have also eased significantly, further lowering the cost to corporate borrowers.
[v] According to Equifax credit file data, total household liabilities have fallen from a peak of $12.4 trillion in August 2008 to $11.1 trillion in December 2013.
[vi] Bankcard originations during the first three quarters of 2013 totaled almost $150 billion, according to Equifax. This is substantially higher than the $90 billion originated during the first three quarters of 2010 at the low, but is well below the $225 billion originated in 2007 before the recession.
[vii] At the peak in the mid-1980s, 35 percent of household liabilities had an interest rate that adjusted within one year of a change in market interest rates.
[viii] The Federal Reserve's stress-testing process is also known as the Comprehensive Capital Analysis and Review or CCAR.
[ix] This is based on the Federal Reserve's quarterly Senior Loan Officer Survey.

[x] The map shows valuation of metropolitan area housing markets based on house price-to-income and house price-to-rent ratios compared with their pre-bubble long-run averages.
[xi] The economic impact of Quantitative Easing is estimated in "The Federal Reserve's Quantitative Easing: Weighing the Cost-Benefit Trade-Off," Chris Lafakis and Ryan Sweet, *Regional Financial Review* (May 2013).
[xii] Each new household must by definition live somewhere and is thus a source of demand for a new home. The estimate that trend household formation is 1.15 million per year is based on projections of population and household size by age group and ethnicity.
[xiii] This is based on simulations of the Moody's Analytics structural model of the U.S. economy.
[xiv] The Bipartisan Budget Act of 2013 was signed into law on December 26, 2013.
[xv] The methods used to measure political uncertainty and quantify its impact on economic growth are described in "A Budget Battle Postmortem," Mark Zandi, *Moody's Analytics special study* (October 2013).
[xvi] Gold prices are currently near $1,200 per Troy ounce, down from a peak of almost $1,800 per Troy ounce, and back to where they were in mid-2010.
[xvii] This perspective was expressed well by former Treasury Secretary Lawrence Summers in a recent IMF speech and seconded by Paul Krugman in a New York Times op-ed.
[xviii] This is the growth in real GDP excluding government spending between the second quarter of 2009 and fourth quarter of 2013. It understates the underlying strength of the private sector as tax increases and the multiplier impacts of reduced government spending also significantly reduce growth in the private sector.
[xix] On a fourth-quarter to fourth-quarter basis.
[xx] A detailed accounting of the causes of the 2008-09 financial crisis and Great Recession is provided in *Financial Shock*, Mark Zandi (FT Press, 2008).
[xxi] The Census Bureau released an update to its long-term population projections in May 2013. While it has long factored in the retiring baby-boom generation into its projections, it meaningfully lowered its projections for foreign immigration in its current forecast.
[xxii] At equilibrium—that is, with full employment, growth at potential rates, and inflation at the Fed's target—the federal funds rate should be approximately 4% and the 10-year Treasury yield closer to 5%. The equilibrium 10-year Treasury yield equals the sum of forward short-term real interest rates of 2.5%, inflation expectations of 2% (equal to the Federal Reserve's target), and a 0.5% term premium.
[xxiii] One option would be to adopt a lower threshold for core consumer expenditure inflation, pledging not to raise short-term rates unless inflation is greater than, say, 1.5%. Core inflation has recently slowed to near 1%. An even more aggressive step would be to reduce the current 6.5% unemployment threshold for raisihg short-term rates.

Chairman MURRAY. Thank you, Dr. Zandi.
Mr. Rosenberg?

**STATEMENT OF DAVID A. ROSENBERG, CHIEF ECONOMIST AND STRATEGIST, GLUSKIN SHEFF + ASSOCIATES INC.**

Mr. ROSENBERG. Chairman Murray, members of the Committee, thank you for the opportunity to appear before you today. I concur with Mr. Zandi about the economy improving, notwithstanding the correction of the stock market. I think it will continue to improve, real GDP likely to be at least 3 percent this year, I think slightly more than that in 2015.

My principal concern, however, comes down more to what I am seeing on the supply side of the economy as opposed to the demand side. You know, when economists discuss their economic outlook, they invariably talk about their GDP growth forecasts, and GDP is actually not about production. It is about spending—consumer spending, housing spending, business spending, Government spending and the like. But there is also the supply side of the economy, which Mr. Zandi alluded to, which receives scant attention. It is equally important, with the critical inputs being productivity and labor force growth.

Over the past year, productivity growth in this country has slowed to a mere 0.3 percent, which is completely abnormal for this stage of the economic cycle; in fact, only in the sclerotic 1970s has productivity been so anemic at this same stage.

The labor force is also growing at only a rate of 0.3 percent, again, disturbingly weak from a historical perspective. So when you combine productivity and labor force growth, the supply side of the economy is expanding actually at less than a 1-percent annual rate, with repercussions I will discuss later.

Fed Chair Janet Yellen acknowledged the supply-side deficiencies in a speech she gave back on March 4th of last year titled "Challenges Confronting Monetary Policy," where she stated, and I quote, "the slow recovery has depressed the pace of capital accumulation, and it may also have hindered new business formation and innovation, developments that would have an adverse effect on structural productivity." And that is indeed what has occurred. Productivity growth has stalled for a country whose long-term trend has been close to 2 percent.

One key reason is because the growth rate in the private sector capital stock over the past 5 years has been nearly stagnant, the weakest pace in any half-decade period in the post World War II era, and there is a direct, though lagged linkage, between capital formation in the private sector, or lack thereof, and productivity growth down the road.

One survey I pay very close attention to is the National Federation of Independent Business monthly poll on confidence in the small business community. The 600-plus small businesses that are part of this survey are asked, among other things, what their top impediment is. In December, 43 percent of them said taxes and Government regulation. Very few times in the past has this share been so high, and there is no other factor today that comes so close as this as the most prominent obstacle.

Now, what about the labor market, the other part of the supply-side story? The dilemma is that people are becoming disengaged from the labor market at an alarming rate. In fact, 2.9 million Americans withdrew from the labor force in 2013, more than doubling the 1.4 million jobs that were actually created. There are now a record 92 million Americans in total who reside outside the labor force. Just 5 years ago, that number was 80 million.

No doubt there is a demographic element since the first of the baby boomers turned 65 in 2011 and 1–1/2 million turn that age annually for the next 15 years, so the retirement wave is obviously one reason. But that does not explain why it is that the number of people in the 25-to 54-year age category who say they have left the labor market because they are "discouraged" has fallen almost 20 percent in the past year.

So something is going on here over and beyond the classic argument that people are either retiring or they are dropping out of the labor market because of a weak economy. The causes are open for debate, but the facts are not, and the facts are that we have a rapidly depleting pool of labor on our hands and it needs to be addressed. According to the Bureau of Labor Statistics, the available pool of labor shrunk 13 percent in 2013 to 16.5 million, which is the lowest it has been in 5 years, and the decline is unprecedented. If the depletion continues at that rate, we will run out of newly available workers in this country in just about 8 years' time.

This is not about the demand for labor, which actually is strengthening. The number of job openings nationwide in November climbed above the 4 million mark for the first time since March 2008 and is up 6 percent from a year ago levels. The problem is that this is not translating into new hirings which are lagging well behind, up less than 2 percent over the past year.

I look at the data, again, from the NFIB survey, and I see that nearly 1 in 4 small businesses have at least one position open right now that they cannot fill. Almost 40 percent say that there have been few or no qualified applicants for the jobs being advertised. In other words, there is evidence of an increasing shortage of skilled labor in this country, which in turn is posing a significant constraint on the sustainability of economic growth.

In conclusion, we do indeed have a cyclical recovery in place, but if aggregate demand expands, say, 3 to 3–1/2 percent over the next 2 years, then we are going to begin to strain scarce supply-side resources in terms of available labor and capital. Then inflation reemerges, interest rates begin to rise, potentially sharply, which is the last thing that fiscal policymakers need since it was actually relief from lower debt service costs that played a critical role in allowing the deficit to recede so substantially in recent years. I estimate that if not for this current low interest rate structure, debt service charges and the budget deficit would be roughly $250 billion higher than is the case today.

Under current official projections, net interest charges go from just over $200 billion now to over $800 billion 10 years from now, rivaling what the Government will be spending on Medicare, accounting for almost the complete deficit at that time, which I can assure you, seeing how this played out in Canada in the early 1990s, will severely impair fiscal flexibility in the future. At that time, nearly 20 cents of every revenue dollar will be diverted towards servicing the debt compared with fewer than 8 cents today, a dead-weight drag on the economy and the public purse that can be averted through macroeconomic policies that foster growth in the productive capacity or the supply side of the economy, keeping inflation at bay even as demand growth expands, thereby freeing up vital financial resources needed to deal with the burgeoning demographic requirements and tough fiscal choices that lie ahead.

Again, thank you for the opportunity to present my views, and I look forward to your questions.

[The prepared statement of Mr. Rosenberg follows:]

# The 2014 Outlook:

# Moving from Constant Crises to Broad-Based Growth

Statement by

David A. Rosenberg
Chief Economist & Strategist
Gluskin Sheff + Associates Inc.

Before the
Committee on the Budget
U.S. Senate

Chairman Murray, Ranking Members Sessions, and members of the committee, thank you for the opportunity to appear before you today to discuss the 2014 economic outlook and ways in which the Congress can enhance prospects for broad-based economic growth in the future.

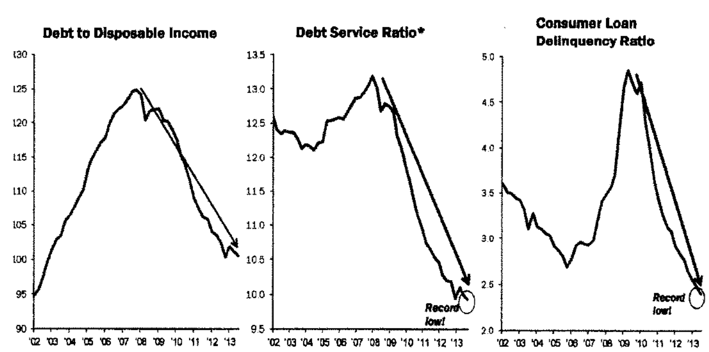
My name is David Rosenberg and I am the Chief Economist & Strategist at Gluskin Sheff, a global wealth management firm based in Toronto, Canada. I have 30 years' experience in economic analysis, largely in the financial sector, including a 10-year stint at Merrill Lynch, initially as the Toronto-based Chief Canadian Economist and Strategist, and then as Chief North American Economist in New York from 2002 to 2009.

Over the past six months or so, I have become more optimistic over the durability of the economic expansion, and see the risks of a recession as minimal. The leading economic and financial indicators I pay most attention to tell me we can probably expect real GDP growth of 3% this year and slightly more than that in 2015. The most pronounced tailwinds are actually the fading of the many headwinds that held back the recovery for the past four years. Notable among these headwinds:

1. The end of the fiscal tourniquet at the state and local government level.
2. The end, at least for now, of the budgetary restraint at the Federal level.
3. What appears to be the end of the painful deleveraging cycle at the consumer level; and it is encouraging to see that the entire parabolic surge in debt-to-asset, debt-to-income and debt-to-net worth ratios that we saw during the household credit bubble from 2002 to 2008 completely unwind over the past five years.

**CHART 1: HOUSEHOLD BALANCE SHEET REPAIR**

**United States: Household Debt Ratios**
(percent)




*Debt-service payments as a share of disposable personal income
Source: Federal Reserve Board, Gluskin Sheff

4. Considering that most real estate agents consider 6 months' supply of unsold homes to be a balanced market, the current national housing unsold inventory backlog, which is now sitting at a tight 5 months' supply, leaves me comforted that homebuilding will continue to contribute to the economic expansion. Housing has not been a headwind for years, but the sector should still play a key supportive role for the economic expansion this year.

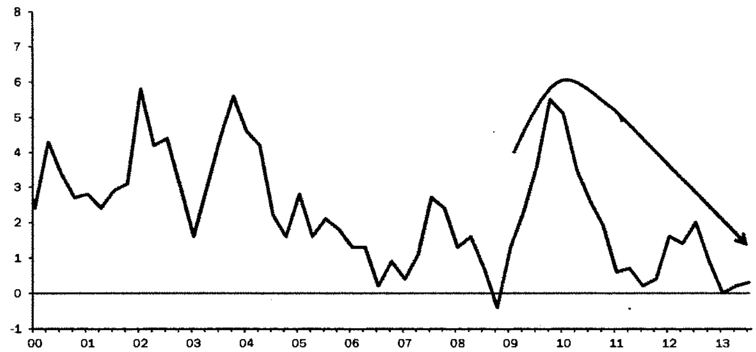
5. The final headwind that has ended is the European recession. We are seeing signs of a pulse along the periphery, as tentative as they may be. Even a fragile recovery is far better than a contraction, which is what we endured over the past three years in a part of the world whose share of global GDP is as large as the United States. A return to European growth will act as an important offset to the sudden slowing and instability we are now seeing in the Emerging Market region.

So with all that uplifting economic commentary, the question is what can go wrong and what is it that we could be missing? My principal concern actually comes down more to what I am seeing on the supply side of the economy as opposed to the demand side. Let me explain. When economists discuss their economic outlook, right away they talk about their GDP growth forecasts. But GDP is not the only measure of economic activity even though it is the one that we primarily focus on. GDP is all about spending — consumer spending, housing spending, business spending, government spending and the like. But there is also the supply side of the economy which receives scant attention but is equally important, and the reason it is ignored is because the Commerce Department doesn't report on 'aggregate supply' every quarter as it does with 'aggregate demand' via the GDP report – for aggregate supply, we have to actually roll up our sleeves and do the work ourselves. The inputs that go into the supply side of the economy are basically two-fold: productivity growth and labor force growth.

So we just got the real GDP data last week, and it was encouraging to see the demand side of the ledger finish 2013 with a 2.7% year-over-year growth rate. But over the past year, productivity has slowed to a mere 0.3% growth rate which is abnormal for this stage of the economic cycle; in fact, only in the sclerotic 1970s has productivity been so weak in the mid-part of the business cycle. And growth in the labor force is also running at only 0.3%, so here we have another measure of economic activity, from the supply side, growing at 0.6% when you combine productivity and labor force growth; and yet another measure, from the demand side, otherwise known as real GDP, running at 2.7%. I'm sure if we had come off a year when GDP growth was only 0.6%, we would all be very concerned about a deficiency of spending. Thankfully, that is not a problem we have to deal with. The problem is squarely on the supply side.

**CHART 2: PRODUCTIVITY GROWTH***

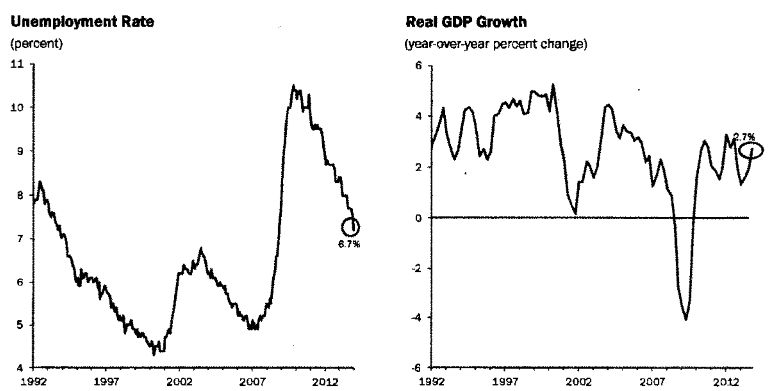
**United States**
(year-over-year percent change)




**Real output per hour of all persons in the nonfarm business sector*
*Source: Bureau of Labor Statistics, Gluskin Sheff*

**CHART 3: WEAK GROWTH BRINGS ALONG LOWER UNEMPLOYMENT?**

**United States**




*Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Gluskin Sheff*

There are two items I would like to bring to the Committee's attention. One is a report that Harvard Professor James Stock and Princeton Professor Mark Watson published in 2012 titled *"Disentangling the Channels of the 2007-09 Recession"* which concluded that 80% of the weaker economic growth experienced this cycle was due to the structural impediments on the economy stemming from supply-side deficiencies. The other item is a speech that Fed Chair Janet Yellen gave on March

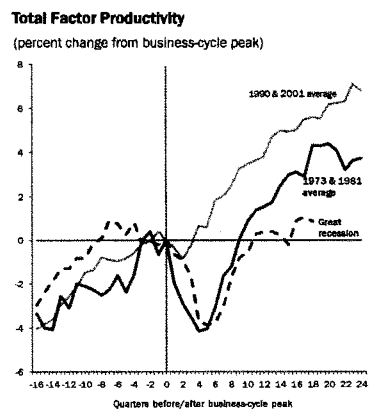
4th of 2013 titled *"Challenges Confronting Monetary Policy"*, where she stated, and I quote, *"the slow recovery has depressed the pace of capital accumulation, and it may also have hindered new business formation and innovation, developments that would have an adverse effect on structural productivity"*.

**CHART 4: SUPPLY CURVE SCLEROSIS**

**United States**

*"The report cites three estimates of the extent to which a lower trend rate explains the weak recovery. One, published in 2012 by James Stock of Harvard University (now a council member) and Mark Watson of Princeton University, derives America's potential growth rate from the long-term average of variables such as employment and productivity.* ***This approach concludes that 80% of the two-percentage-point shortfall in growth relative to other recoveries is caused by slower potential."***

*The Economist, March 23, 2013*

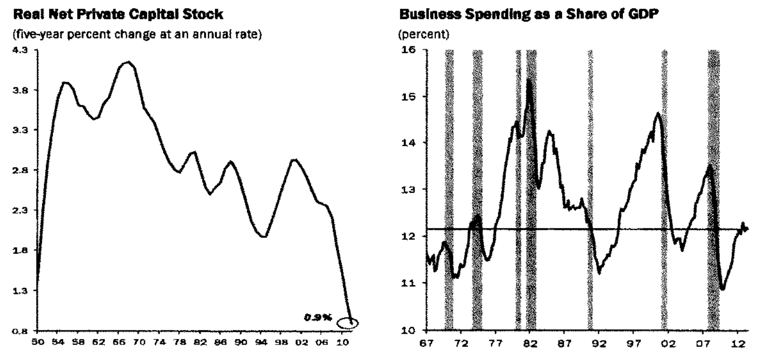



*Source: Federal Reserve Bank of San Francisco, The Economist*

And that is indeed what has occurred. Productivity growth has suddenly stalled for a country whose long-term productivity trend has been close to 2% on an average annual basis, and the question is why? From my vantage point, the reason is because the growth rate in the private sector capital stock over the past five years has been practically stagnant, just 1% annually, which goes down as the weakest pace in any half-decade period in the post-world-war-two era, and there is a direct, though lagged linkage, between capital formation, or lack thereof, and productivity growth down the road.

**CHART 5: WEAKEST GROWTH IN THE PRIVATE CAPITAL STOCK IN SIX DECADES**

**United States**

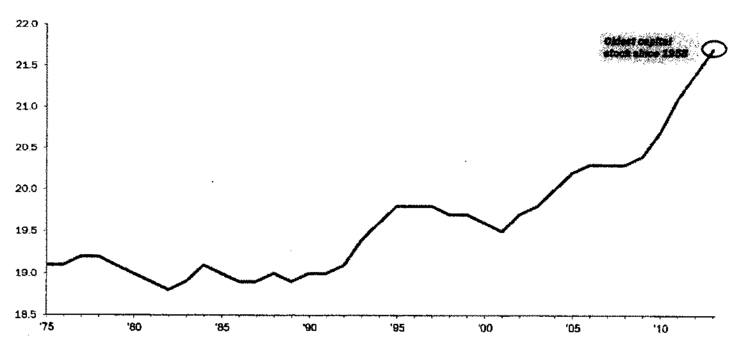



**Shaded regions represent periods of U.S. recession*
*Source: National Bureau of Economic Research, Federal Reserve Board, Gluskin Sheff*

So corporations have done a superb job in using its $2 trillion cash hoard towards delivering returns to shareholders via share buybacks and dividend payouts, but have not done much in the aggregate to invest organically in their own businesses beyond replacing obsolescence or depreciation. The data tell us that we have seen inadequate real business fixed investment to the point where the erosion in the capital stock is now impairing productivity growth. In fact, the average age of the private sector capital stock is fast approaching 22 years – that is total plant and equipment. The last time the private sector capital stock was this old and obsolete was back in 1958.

**CHART 6: AN AGING AND AGED CAPITAL STOCK**

**United States: Average Age of Private Fixed Assets**
(years)



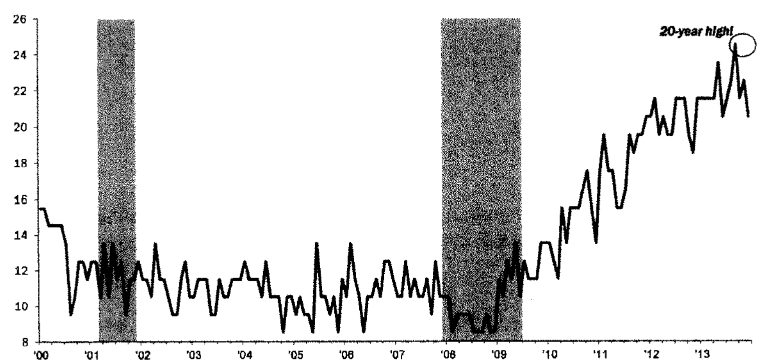

*Source: Bureau of Economic Analysis, Gluskin Sheff*

The situation is all the more unusual because the cost of capital could scarcely be lower than it already is, so something must be holding back 'ex ante' expected rates of return on long-term capital projects, or containing the animal spirits of CEOs and CFOs, and maybe this all boils down to merely injecting some certainty or clarity from a public policy standpoint to entice the business sector to reinvest in the real economy and arrest this disturbing downtrend in productivity.

One survey I pay very close attention to is the National Federation of Independent Business monthly poll on confidence in the small business sector. The 600-plus small businesses that are part of this survey are asked, among other things, what their top impediment is. In December, 43% of them said taxes and government regulation, and very few times in the past has this share been so high, and there is no other factor that comes close as the most prominent obstacle. There are always going to be business folks griping about government, but in the past, when this metric was closer to 30% than 40%, we found that there was much more vitality to capital spending and productivity. Perhaps a case can be made here for the sort of corporate tax reform Canada embarked on in the late 1980s and early 1990s by widening the base and cutting top marginal rates, reducing the complexity of the system in the process.

**CHART 7: GOVERNMENT REGULATION GETS IN THE WAY**

**United States: NFIB: Government Requirements as the Top Problem**
(percent of respondents)




*Shaded regions represent periods of U.S. recession*
*Source: National Federation of Independent Business, Gluskin Sheff*

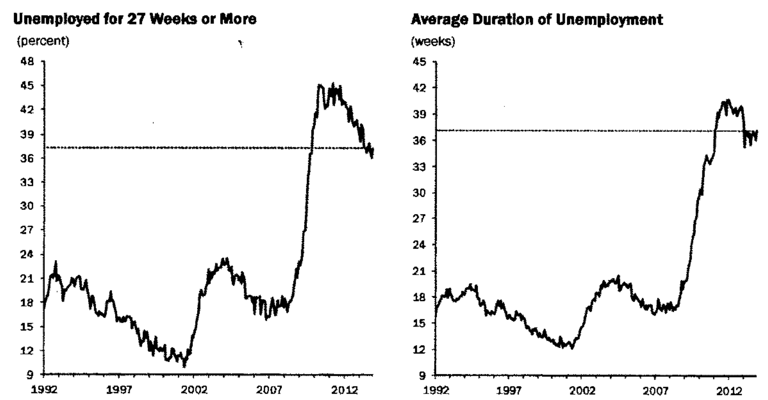
So I have dealt with the productivity side of the supply side story. What about the labor market?

Once again, in that speech by then Fed Vice-Chair Janet Yellen last March, the then Vice-Chair but current Fed Chairman said, and I quote:

*"The large shortfall of employment relative to its maximum level has imposed huge burdens on all too many American households and represents a substantial social cost. In addition, prolonged economic weakness could harm the economy's productive potential for years to come. The long-term unemployed can see their skills erode, making these workers less attractive to employers. If these jobless workers were to become less employable, the natural rate of unemployment might rise or, to the extent that they leave the labor force, we could see a persistently lower rate of labor force participation."*

**CHART 8: LONG-TERM UNEMPLOYMENT ... A BIG PROBLEM**

**United States**




*Source: Bureau of Labor Statistics, Gluskin Sheff*

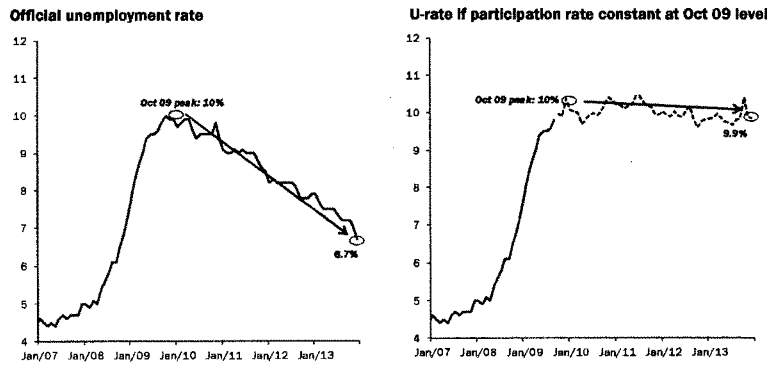
I also discovered a report by the economists at the Chicago Fed, published last July and titled *"Estimating the Trend in Employment Growth"*, and here was the conclusion. Again, I quote:

*"For the unemployment rate to decline, the U.S. economy needs to generate above-trend job growth. We currently estimate trend employment growth to be around 80,000 jobs per month, and we expect it to decline over the remainder of the decade, due largely to changing labor force demographics and slower population growth".*

I can't speak for the Committee, but I find that conclusion startling. This is the way I look at the situation. In the past four years, the unemployment rate has declined from 10% to 6.7%. And all it took to accomplish that tremendous tightening of the labor market was average GDP growth of 2.4% at an annual rate. Only three other times in the past six decades has the unemployment rate fallen this far this fast: in the early 1950s, when growth averaged 6.7% per annum; in the late 1970s when GDP growth averaged 4.8%, and in the mid-1980s when growth averaged 5.2%. Today we accomplished this feat with only 2.4% growth which is disturbing because it means that it is not taking much in the way of incremental economic activity to drain valuable resources out of the labor market.

**CHART 9: UNEMPLOYMENT RATE DOWN ... BUT FOR THE RIGHT REASON?**

**United States: Unemployment Rate**
(percent)



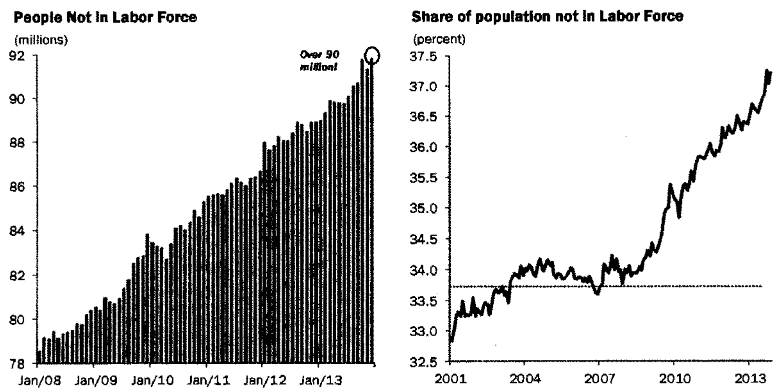

*Source: Bureau of Labor Statistics, Gluskin Sheff*

The dilemma is that people are becoming disengaged in the labor market at an alarming rate, for a variety of reasons which I will get into. In fact, the number of Americans who reside outside of the natural confines of the labor force soared 2.9 million in 2013 which far exceeded the 1.4 million jobs that were actually created. So people who say that the unemployment rate has been falling for the wrong reasons may not be far off the mark, but the question is why. As Janet Yellen has said, a good part of the explanation is the declining skill set among the long-term unemployed who number 3.9 million and represent 37% of the total ranks of the joblessness, which is still extremely high by historical standards — double the historical norm. But that is not the complete answer.

There are now 92 million Americans in total who reside outside the confines of the labor force. Five years ago that number was 80 million. Ten years ago it was 75 million. No doubt there is a demographic element since the first of the baby boomers turned 65 in 2011 and 1½ million turn that age annually for the next 15 years so the retirement wave is obviously one reason. But that doesn't explain why it is that the number of people in the 25-54 year age cohort who say they have left the labor market because they are "discouraged" has fallen 18% in the past year. When you look at this prime-aged adult cohort, what we find is that the number in this segment who have withdrawn from the labor market but don't want a job rose almost 5% last year, while those who said they have left the workforce but would take a job if offered one actually fell more than 3%.

**CHART 10: A RECORD NUMBER OF AMERICANS HAVE LEFT THE LABOR FORCE**

**United States**



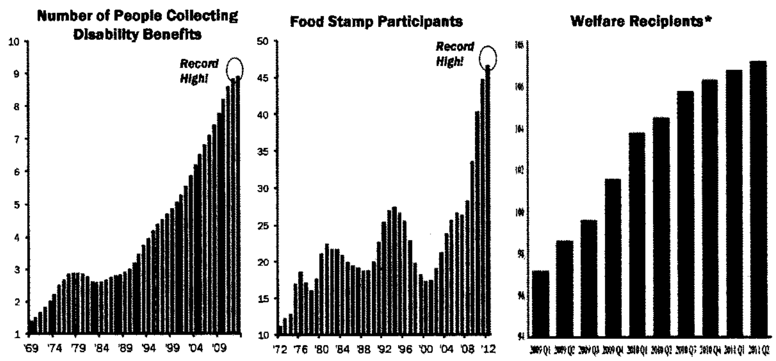

*Source: Bureau of Labor Statistics, Gluskin Sheff*

So something is going on here over and beyond the classic argument that people are either retiring or are dropping out of the labor force because of a weak economy — in fact, we know from other pieces of the employment report that the number of people who were working part-time for economic reasons actually declined 2% last year.

One theory that deserves examination is that we may have an abundance of separate benefits programs that provide for the disenfranchised in a very piecemeal and inefficient manner that are also perhaps abused or overly relied upon by some, which may lead to a distortion of work incentives. I point to a testimony on this matter by C. Eugene Steuerle on February 14th, 2013 to the House Committee on Oversight and Government Reform titled *"Labor Force Participation, Taxes and the Nation's Social Welfare System"*. Or perhaps the underground or barter economy is expanding at a faster rate than is generally appreciated and not getting picked up in the official employment numbers. Again, this is very tough to verify but offers a plausible explanation for why so many people seem to be falling through the cracks of the labor market as traditionally defined.

**CHART 11: GETTING PAID NOT TO WORK**

**United States**
(millions)




** Figures count means-tested welfare, not Social Security or Medicare*
*Source: Social Security Administration, Department of Labor, Budget Committee Republican staff, U.S. Census' Survey of Income and Program Participation, Gluskin Sheff*

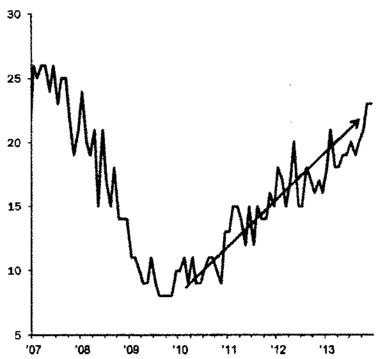
But what I do know with certainty is that we have a rapidly depleted pool of labor on our hands and it needs to be addressed. In fact, the Bureau of Labor Statistics reports on the size of the available pool of labor each month and that pool shrunk 13% in 2013 to 16.5 million which is the lowest it has been in five years and the decline is unprecedented. If this depletion continues at that rate, we will run out of available workers in this country in just about seven years – sooner than Japan.

I look at the data, again from the NFIB survey, and I see that 23% of small businesses have 'at least one position' open right now that they cannot fill; that is a number we have not seen in six years. The share saying that there have been 'few or no qualified applicants' for the jobs being advertised has risen to 38% from 33% a year ago. This is not about the demand for labor which is strengthening according to practically every survey on the matter. In fact, the number of job openings nationwide in November crossed above the 4 million mark for the first time since March 2008 and they are up 6% from where they were a year ago. The problem is that this is not translating into new hirings which are lagging well behind, with only a 1.7% annual rate of growth. In the latest Fed Beige Book, there were no fewer than two dozen references to "skilled labor shortages" in manufacturing, construction, transportation services and technology services which span almost one-quarter of the private sector workforce.

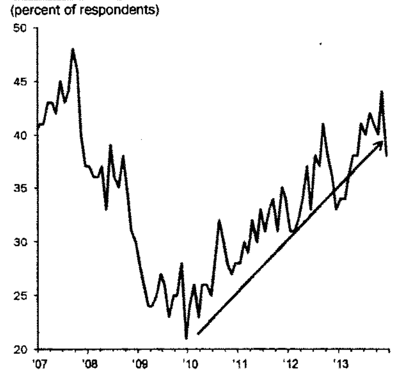
**CHART 12: SIGNS OF SKILLS SHORTAGE**

**United States: NFIB Small Business Survey**

**Firms With Positions Not Able to Fill Right Now**
(percent of respondents)



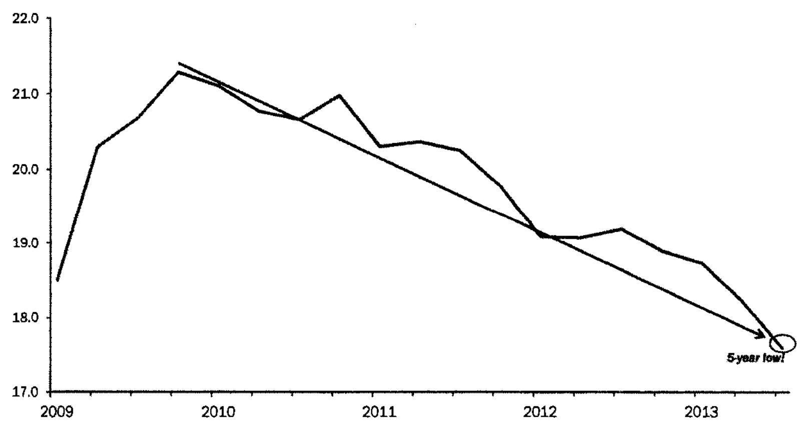

**Businesses with Few or No Qualified Applicants for Job Openings**
(percent of respondents)




*Source: National Federation of Independent Business, Gluskin Sheff*

**CHART 13: AVAILABLE LABOR SUPPLY**

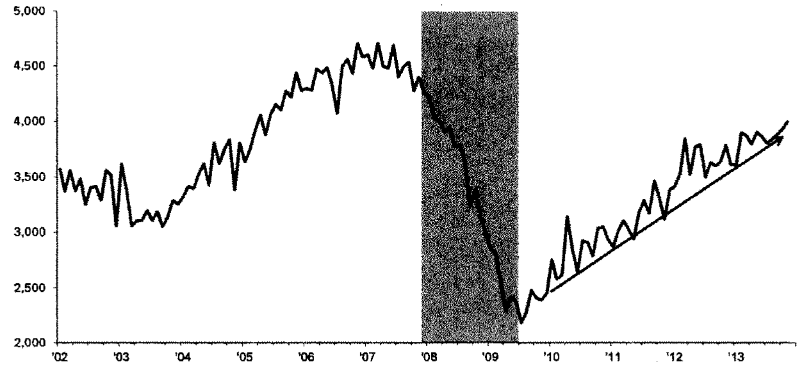
**United States**
(millions)




*Source: Bureau of Labor Statistics, Gluskin Sheff*

**CHART 14: JOB OPENINGS ON THE RISE**

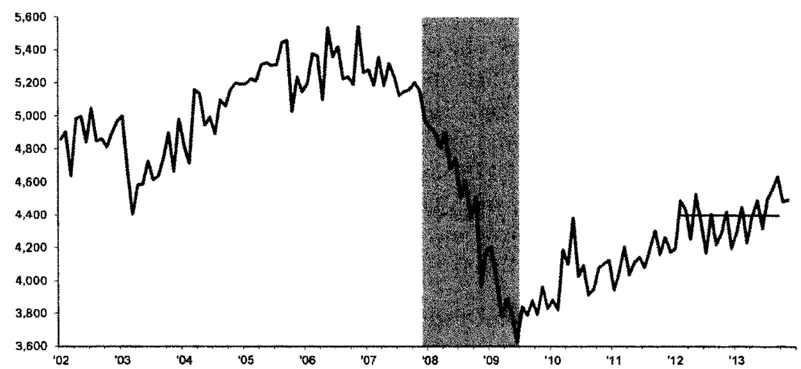
**United States: Job Openings and Labor Turnover Survey: Job Openings**
(thousands)




*Shaded regions represents period of U.S. recession*
*Source: Bureau of Labor Statistics, Gluskin Sheff*

**CHART 15: BUT HIRING LAGS BEHIND**

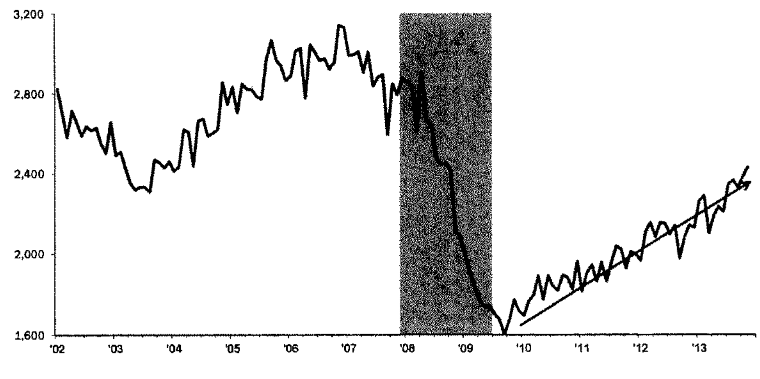
**United States: Job Openings and Labor Turnover Survey: New Hires**
(thousands)




*Shaded regions represents period of U.S. recession*
*Source: Bureau of Labor Statistics, Gluskin Sheff*

**CHART 16: NUMBER OF JOB QUITTERS RISE TO CYCLE HIGH**

**United States: United States: Job Openings and Labor Turnover Survey: Quits**
(thousands)




*Shaded regions represents period of U.S. recession*
*Source: Bureau of Labor Statistics, Gluskin Sheff*

From my lens, this requires emphasis on education, and I refer specifically to higher education because the unemployment rate for college graduates is now back close to 3%; college dropouts have over a 6% unemployment rate; those with a high school diploma have over a 7% unemployment rate; and those that never finished high school have an unemployment rate stubbornly close to 10%. The problem for employers is that they now have just 1.6 million people with a post-secondary education who are without a job but engaged in a search to choose from, and 6 million people without a degree who are knocking at their doors. Just to put the skills mismatch evident in that NFIB survey into some perspective, as well as another reason why productivity growth has decayed as much as it has. So one key to sustainable noninflationary growth and durable prosperity lies in helping people gain access to higher education — that is where the inequality is.

On top of that, I would say immigration and that includes the offspring of immigrants to the country as a key dynamic that I believe needs to be nurtured. The BLS reports the jobs data by ethnicity, and there is some valuable data here to glean. In the year to December, the White population saw employment growth stagnate and the labor force for this segment shrank 0.7%. Go to the Asian segment and here we saw employment growth come in at 5.2% for all of 2103 and the labor force expand 2.5%. Much the same for the Hispanics — employment growth of 2.7% in 2013 with an additional 1.3% in this group participating in the jobs market. Consider for a moment that there would have been practically no growth in total U.S. employment last year if not for these two minority groups — they represent

20% of the overall employment pie and yet managed to be responsible for 75% of the national job creation in 2013. Now, I'm not a sociologist and so I am not equipped to make sweeping statements over culture and the work ethic, but these minorities clearly seem motivated to be looking for work and they are finding work, just as other minority groups before them. Canada's experience in attracting foreign workers with skills and education, through its Immigrant Investor, Entrepreneur and Federal Skilled Trades Programs may be a template worth exploring. And it is worth noting that Canada's unemployment rate, on an apples-to-apples comparison is now 5.7% and has accomplished that with a participation rate of 66.4% compared to the 35-year low participation rate of 62.8% in the United States, and that 3.6 percentage point gap between the two countries is without precedent.

The big picture here is that I believe the policy agenda should be about boosting the productive capacity of the economy — the non-inflationary growth potential, in other words. Labor force growth in the past year is running at a fraction of one percent as is productivity, which means we have an historically extremely depressed potential growth rate on the supply side of the economy, far lower than the 3%-to-3½% range during the strong labor force growth years of the 1980s and the heady capital spending years of the 1990s and I believe lower than the 2%-to-2½% level the economics consensus has assumed in the current context.

In conclusion, we do indeed have a cyclical recovery in place, but if aggregate demand expands 3%-to-3.5% over the next two years, then we are going to begin to strain scarce supply-side resources in terms of available labor and capital. Then inflation re-emerges and interest rates begin to rise, potentially sharply, which is the last thing fiscal policymakers need since it was relief from lower debt-service costs that played such a crucial role in allowing the deficit to recede substantially in recent years. I estimate that if not for the current low interest rate structure, debt-service charges and the deficit would be $250 billion higher than they are today. But under current OMB projections, net interest charges go from $212 billion in 2013 to $822 billion in 2023, rivaling what the government will be spending on Medicare and severely impairing fiscal flexibility. At that time, nearly 20 cents of every revenue dollar will be diverted towards servicing the debt compared with fewer than 8 cents today, a dead-weight drag on the economy and the public purse that can be averted through macroeconomic policies that foster growth in the productive capacity or supply side of the economy, keeping inflation at bay even as demand growth expands, thereby freeing up vital financial resources needed to deal with the burgeoning demographic requirements and tough fiscal choices that lie ahead.

Thank you.

Chairman MURRAY. Thank you again to all three of you for being here today.

Dr. Zandi, I want to start with you. You testified before this Committee last fall and warned about the consequences of failing to raise the debt ceiling. You indicated that exceeding the debt ceiling would, and I quote, "have catastrophic consequences for the economy and even threatening default could have significant negative consequences for our economy."

In today's testimony, you stated that the principal threat to the stronger U.S. economic growth you see for this year is a policy mistake, listing the debt limit as the most immediate risk that is out there.

We are hearing again from some of our Republican colleagues raising the possibility of waging a fight again over this debt limit, and so for those watching at home, I wanted you to just explain what it would mean for them and their families if Congress failed to raise the debt limit, even temporarily.

Mr. ZANDI. It would be catastrophic. If we get to that March 3rd deadline—and there is a lot of uncertainty around that given tax refunding and other factors that will influence payments by the Treasury. But I think the most likely drop-dead date would be March 3rd. On that day, if memory serves, there is a $26 billion payment to Social Security recipients. It would be unlikely that the Treasury would be able to make that payment in full. So the most immediate obvious impact would be Social Security recipients would not get their checks in full or on time. And I think that mere fact alone would be incredibly debilitating and scary to everyone and would be enough to undermine confidence, undermine the recovery, and push us back into recession. But extended any longer than that, of course, it would be—the severity of the economic impacts would intensify very, very rapidly.

So it is just not a path we want to go down, and it is not even a path we would really, I think, should entertain because that is by itself very counterproductive. It does undermine confidence. It undermines the willingness of business people to step up, increase their hiring, increase their investment. It weighs on economic growth. There is increasing statistical evidence of the impact of all the budget brinkmanship that has occurred over the past several years on economic growth, on jobs, on unemployment. So in my view, it would be a mistake to even go down the path—

Chairman MURRAY. Or threaten or—

Mr. ZANDI. Or threaten to not do it.

Chairman MURRAY. Okay. Mr. Greenstein, I wanted to ask you a question as well. As you know, in recent years some of our colleagues have attempted to use the need for Government to perform the most basic tasks—paying its bills, raising the debt limit—as leverage to extract major policy concessions from this administration. My question is: As one of our Nation's leading experts on budget issues, does raising the debt ceiling add to the deficit?

Mr. GREENSTEIN. No.

Chairman MURRAY. Well, is it not the case that increasing the debt limit only allows the Treasury to pay the bills that resulted from our policy decisions that have already been put in place?

Mr. GREENSTEIN. That is right. Raising the debt limit does not change the level of benefits in any entitlement program; it does not change the tax obligation that any individual or corporation faces. It does not change the caps, the ceilings on discretionary spending. It does not have—

Chairman MURRAY. All that was done in the budget agreement and the appropriations bills that we just did.

Mr. GREENSTEIN. That is right.

Chairman MURRAY. And those decisions were made.

Mr. GREENSTEIN. That is right, and they are in law, and they hold, whether the debt limit is raised or not, except that as Dr. Zandi has said, if the debt limit is not raised, then the Government basically is faced with doing things like breaking the Social Security law by not sending the checks out on time because it does not have the resources with which to do so.

Chairman MURRAY. Or people who are waiting for their IRS money back.

Mr. GREENSTEIN. Yes.

Chairman MURRAY. Okay. I really appreciate that.

Dr. Zandi, let me go back to you and talk about the bipartisan budget agreement. That was the result of some pretty tough negotiations on both sides. Republicans and Democrats compromised for the greater good. Neither one of us agreed it was perfect. Chairman Ryan did not think it was perfect; I did not think it was perfect. But we felt it was the right way to go for our families and communities and business rather than where we were.

Importantly, the budget deal unwound some of the spending cuts from sequestration and reset the appropriations levels for 2 years, 2014 and 2015. And in doing do, we were able to lessen some of the damaging consequences of sequestration that concerned actually members on both sides of the aisle here and remove the threat, again, of another Government shutdown and provided some certainty so that Chairwoman Mikulski could work with her counterpart and get our bills passed.

Can you help us today better understand the impact—or the direct and indirect consequences of the bipartisan budget deal and explain how the increase in policy certainty for this 2-year period and the decrease in austerity helps our economy?

Mr. ZANDI. Yes, I think the Bipartisan Budget Act was a significant plus for the economy, both directly and indirectly. Directly, as you point out, it reduces some of the spending cuts that were slated for 2014 going into 2015, and the sequester itself, which were poorly designed spending cuts. So eliminating that was very therapeutic for the economy in a very direct way.

But perhaps most importantly is the indirect consequence, and that is the impact on confidence and sentiment.

Chairman MURRAY. The mental health of the country.

Mr. ZANDI. Yes, really. It is hard to measure, admittedly, and it feels squishy, but I do think there is growing evidence that all of the budget battles that we have experienced, the fiscal cliff, the debt limit debacle back in the summer of 2011—and there has been a string of them—have been very hard on the collective psyche, and it is the key reason, one of the key reasons why people have not fully engaged and not taken the risks that they normally take in an expansion, particularly business people. It is one of the reasons why small businesses have been so nervous about taking a chance.

I sense in the wake of the budget deal that sentiment has dramatically improved. We have a survey we conduct of business people every week—we have been doing it since January of 2013—and it hit a record high in January of—excuse me. We have been conducting it since January of 2003, so for 11 years. It hit a record high in January of 2014, by orders of magnitude, and expectations—you know, we ask a lot of questions, one of which is, "How do you think things are going to be 6 months down the road?" They are far and away as strong as they have ever been in this survey.

So my sense is that because of the deal and because of what it means going forward with regard to the tensions here in Washington, we are going to get more risk taking, we are going to get more hiring, we are going to get more investment, business expansion, and a stronger economy. So I think the deal, the Budget Act, was very, very important to solidifying a much stronger economy going forward.

Chairman MURRAY. Okay. Thank you very much.

Senator Sessions?

Senator SESSIONS. Madam Chairman, I would yield to Senator Crapo at this time.

Chairman MURRAY. Okay.

Senator CRAPO. Thank you, Senator Sessions, and thank you, Madam Chairman.

Dr. Zandi, I would like to start with you. In your introductory comments, you discussed the fact that some of the drag on the economy that is a result of Federal policies is going to be softening. We can expect some higher growth in the next few quarters, as I understood your testimony. The question I have, though, is: How do we determine that? And what I am getting at is, isn't the debt crisis that we face, isn't the level of debt that we are carrying a constant drag on the economy that needs to be resolved?

Mr. ZANDI. Yes, I agree. You know, I do think you have made significant progress. You stabilized the fiscal situation. The deficit to GDP is shrinking. The debt-to-GDP ratio is stable. And under reasonable economic assumptions—and they are reasonable because they are my assumptions, you know, and they are close to CBO—we are going to have a stable fiscal situation for the next several years. Good, great, it restores confidence and I think allows the private economy to kick into gear.

Senator CRAPO. But we still have a looming debt crisis.

Mr. ZANDI. Exactly, and I do not think we should feel at all comfortable with a debt-to-GDP of 73, 74 percent. It is double what it was before the recession. Thirty-five, 40 percent is perfectly manageable, we are okay. Seventy-five percent I think is—we have no room for error if something goes wrong. And as importantly, as you move into the next decade, again, under reasonable assumptions, the deficits are going to start to rise; the debt load is going to start to rise. So your work is not done. You have more work to do.

Senator CRAPO. As I see it, we have done some modest improvement in terms of controlling discretionary spending, although we have backtracked on that a little bit from the last Congress' Budget Control Act. We have seen about $2 trillion of new taxes come into play, including everything that has happened over the last 4 or 5 years. So we have got more tax revenue coming in. But we have done very little in terms of reforming the Tax Code, and we have done very little in terms of reforming entitlement spending. And it seems to me that we need to pay strong attention to all of those areas. Would you agree to that?

Mr. ZANDI. Absolutely. Absolutely. The long run looks dark because our entitlement programs are not on a sustainable footing, and we do need tax reform both to make the Tax Code more efficient but also to raise more revenue. So we need both tax reform and—

Senator CRAPO. The pro-growth element of what we need to get done is critical, and in the Tax Code I think is where we need to look for that.

Mr. ZANDI. Absolutely.

Senator CRAPO. Thank you.

Mr. Rosenberg, I would like to talk to you in my remaining few minutes about the issue of quantitative easing. As we try to look at what is happening in our economy, a number of us are very concerned that the Federal Reserve has basically been propping up our credit for—well, to the tune of trillions of dollars now, and we think there is a price that is going to be paid for that ultimately.

First of all, is that correct? Has the quantitative easing put us into a posture of facing an increased risk of inflation or other difficulties in the economy? And what will be the effect of the ending of the Federal Reserve's quantitative easing, if and when the Fed ever does start actually easing off?

Mr. ROSENBERG. Thank you, Senator. Well, I think the Fed has already started that process in terms of tapering, which is—

Senator CRAPO. Just to some extent.

Mr. ROSENBERG. —reducing the rate of growth of its balance sheet. That is a very complicated question, and I will tell you why: because so much of what happens in the marketplace is psychological. So we will draw some sort of linkage between what the Fed is doing with its balance sheet and, say, what the stock market is doing or what asset prices are doing. And what is interesting is that when you take a look at the past few years, this money, in quotes, that has been created by the Fed through quantitative easing, well, 90 percent of that money creation has actually just ended up as excess reserves on the balance sheets of the commercial banking system.

So you can really as a central bank create all the money you want, but if it just sits in the garage and does not get recirculated in the economy, it is not really going to have a sustained inflationary impact. The way economists would view that is one of the reasons why we have not had an inflationary impulse is because the velocity of money or the turnover rate has continued to decline and acted as a huge offset to the so-called money creation.

So the inflation would ultimately come if and when we get the commercial banks engaged in a new credit cycle, and there are reasons why that is not happening from a regulatory standpoint. But the inflation would come from a classic quantitative—quantity theory of money identity. If we were to go through a new credit cycle, if that velocity of money begins to turn around and go higher, we go into a whole new credit cycle, then the inflation would ensue.

There are other reasons why I think inflation could rise for reasons I said before, but from a monetary standpoint, it is unclear to me that the quantitative easing is going to lead to inflation barring a new credit cycle formulating.

Senator CRAPO. Thank you.

Mr. Greenstein, could you comment on this as well?

Mr. GREENSTEIN. I am afraid I am not an expert on things like quantitative easing. I think Dr. Zandi could opine, but I hesitate to offer an opinion on something that I really do not have the expertise in.

Senator CRAPO. All right. We will let you pass then.

Dr. Zandi?

Mr. ZANDI. I do not think inflation is an issue, no. I think with a 6.7 percent unemployment rate and with labor force participation as low as it is, and a lot of discouraged workers, I think we are a long way from monetary policy resulting in inflationary pressure. So I do not view that as a concern at this point.

Senator CRAPO. Do you view there to be risk or concern about the level of quantitative easing that we have seen so far?

Mr. ZANDI. No. I think that the Federal Reserve had no choice in what they did. They had to bring long-term interest rates down, mortgage rates down to help the housing market, support asset values. So I think they did what they had to do. It is, you know, obviously not the most desirable policy, but we are not living in a very desirable time. So they did what they had to do. And there are downsides to it. You know, I—

Senator CRAPO. That is what I am getting at. I mean, I do not think that the Fed can undertake this for the length of time and to the level and scope that it has without consequences. What are those downsides?

Mr. ZANDI. Well, there are a number of potential downsides. You mentioned inflation, but I discount that. I think the most serious potential issue are bubbles in asset markets. And you could argue, reasonably so, that there was bubble-like conditions in a number of emerging markets that are now getting wrung out because the Federal Reserve is changing policy. And so this dislocation—the turmoil in financial markets we are seeing right now is in part related to the Fed starting to exit, and there is a case—in my view, that is the most significant potential downside to what they are doing. And it could show up in other asset markets. You know, they are scouring the planet for potential imbalances in the financial system. Before the crisis, I would not get a call from anybody, any regulator, about any problem. Now I get calls every week from every regulator all the time. You know, "What should I be worried about?" Which I view as quite encouraging. And so they are really thinking through what could be going wrong.

But at this point, this bubble concern, it is a legitimate concern. I just do not think it is an overwhelming one. And it is not a reason not to go down the path of quantitative easing.

Senator CRAPO. All right. Thank you.

Chairman MURRAY. Thank you.

Senator Whitehouse?

Senator WHITEHOUSE. Thank you, Chairman. Thank you, gentlemen.

I want to touch on health care in the first instance. Mr. Greenstein, your testimony is that we have reduced the debt by $2.8 trillion deficit reduction as a result of the tax increases and the spending cuts that have already been implemented.

Mr. GREENSTEIN. Closer to $4 trillion, if you count sequestration.

Senator WHITEHOUSE. If you count the out-years of sequestration, correct.

Mr. GREENSTEIN. Correct.

Senator WHITEHOUSE. Now, in parallel with that, CBO has just reported again on its forecast on Medicare-Medicaid prices, and they have reduced the proposed Medicare-Medicaid spending that they anticipate by $1.2 trillion, and in today's news, before anybody's testimony could adapt to it, I gather that they have added another $150 billion in Medicare and Medicaid savings in the out-years in their projections. Is that number incorporated into your $2.8 trillion or your $4 trillion? Or is that a further addition to it in savings in the out-years?

Mr. GREENSTEIN. Some of it is incorporated and some is not. So the part that is incorporated is the part that results from legislative action. For example, changes in Medicare that were—well, no, actually this is since 2010, so it already had in the starting point the changes in the Affordable Care Act.

The $1.2 trillion figure, which was CBO's estimate of Medicare and Medicaid costs through the coming decade relative to what it had forecast back in 2010 and before today's numbers reflects what we call economic and technical factors.

Senator WHITEHOUSE. Is it a part of the $2.8 trillion?

Mr. GREENSTEIN. Is it a part of the $2.8 trillion? Really, no, because the $2.8 trillion is limited to things that Congress enacted and CBO scored from legislation. And that $1.2 trillion is lower prices and payouts in Medicare and Medicaid just because the costs of health care systemwide—Medicare, Medicaid, and the private sector—have been rising at a significantly slower rate. So that is not reflected in the $2.8 trillion.

Senator WHITEHOUSE. So the point that I would make is that we are making ground on Medicare and Medicaid, the anticipated costs in the out-years are starting to decline, and by real numbers. And trillions are big numbers. But we still remain a country that is burning 17 to 18 percent of GDP on health care. We are still, by about a 50-percent factor, more expensive than all of our—including our most expensive industrial competitors in the OECD. There are huge opportunities for savings in ways that are win-wins, improving the quality of care by lowering costs, and I will just take this opportunity to again call on the Obama administration to please try to set a goal, a target for the administration and what they intend to accomplish with their delivery system reform programs. It is the one big gap in what I think is good implement and, frankly, a pretty good law. The Affordable Care Act, about a third of it was dedicated to this delivery system reform stuff, and we never hear about it from our Republican colleagues because it is noncontroversial. It is being used in Wisconsin. it is being used in Alabama. It is being done in people's home States. ACOs are standing up. Hospitals are taking advantage of it. Prices and costs are beginning to come down. Care is improving. And it is all to the good. But it is being done without a goal, and I think for the President to set a hard goal would add a lot of focus to the effort that is underway, and we really need to get that done.

The last point I will make, Mr. Greenstein, would you mind calling up your Figure 9, tax expenditures are very costly, onto the screen? Can somebody do that who is in charge of AV? Or are we past that?

Mr. GREENSTEIN. I do not know if they are programmed—

Senator WHITEHOUSE. I go back to AV. I am sorry.

All right. It is a good graphic. You know, we talk a lot about the concerns about the cost of Social Security, $768 billion on the graph, the costs of Medicare and Medicaid $716 billion on the graph. Tax expenditures, the money that goes out the back door of the Tax Code is $1.08 trillion, and we really have not addressed that yet. And I would like to ask the witnesses: Do we need to address the $1.8 trillion going out the back door of the Tax Code? And would you be able to help with the income inequality problem in the country by addressing the $1.8 trillion going out the back door of the Tax Code? Let me go right across. One minute, so pretty quick answers. Sorry.

Mr. ZANDI. I think tax reform is addressing this issue of tax expenditure. That is a big part of it.

Senator WHITEHOUSE. Which we have not done.

Mr. ZANDI. Which we have not done and we need to do. It can make the system more efficient, more fair, easier to implement, and at the end of the day generate revenue, which we desperately need. And as you point out, it has important implications for the distribution of income as well. So this is one place where—

Senator WHITEHOUSE. Why does it have important—

Mr. ZANDI. Well, the benefits of the tax expenditures accrue mostly to upper-income households, for very obvious reasons. They pay most of the taxes, and they are going to get most of the benefit. Whereas, the spending benefits generally go to lower-and middle-income households. So if you can focus on tax expenditures—which tax expenditures is simply spending through the Tax Code, no different from an economic perspective. So when we talk about spending cuts, reducing tax expenditures is the same thing. So we should be focused on that to address this issue of income inequality.

Senator WHITEHOUSE. Well, my time has run out, but I would urge my Republican colleagues to allow us to begin to address these massive multi-billion, -trillion dollar tax expenditures which so far they have protected with a vehemence that is really remarkable.

Chairman MURRAY. Senator Sessions.

Senator SESSIONS. Thank you. With regard to the earned income tax credit, which is certainly one of the larger tax expenditures that we have, I do think as a matter of policy that is preferable to the classical welfare benefits. It is tied directly to work. It incentivizes work. It helps people to work.

But I would share with my colleagues, the way it is paid undermines that concept because people file a tax return, they get a big tax check, and they do not really realize it is tied to their work.

It would amount to about $1 an hour if you put it on people's paychecks, and I think with the new modern computer payrolls, that could be done pretty easily, and I think that would help us. So I think that is a move that I would be supportive of, although we have got other problems.

With regard to the labor situation in the country, Gene Sperling has said, the President's adviser, a few weeks ago, we have three applicants for every job, and I would suggest to all of you market economists, if we have a shortage of labor, why are not wages going up? Wages have been going down, and they continue to go down. So I do not think we have some compelling need to find more labor. I think the compelling need is to take the millions of people that are out of work and incentivize them and train them to get them back into the workforce. For what it is worth, that is my thinking.

Mr. Rosenberg, according to the 2014 Index of Economic Freedom, Canada is more economically free than the United States, which is a change. I guess the progress Canada has made, would you say that is good? If the United States were more economically free, would that help us increase the gross domestic product?

Mr. ROSENBERG. Well, thank you for the question, Senator, and let us hope that translates into a Gold Medal for the men's hockey team in Canada.

[Laughter.]

Mr. ROSENBERG. Well, in answer to the question, the answer is yes, and, you know, as I sit here today, I feel almost as though I have been transported back in time in a similar setting in Ottawa 15, 20 years ago, when Canada faced very similar fiscal pressures that the U.S. does today. So in answer to your question, yes, I think that in Canada it comes down to the question before from Senator Whitehouse about the importance of lowering tax rates. What was interesting in Canada was that the party that really got the ball rolling on the fiscal mess the country was in were the liberals, and they were actually the party ultimately in the mid-1990s that solved the problem. But they managed to convince Canadians that fiscal sustainability was important.

The point I tried to bring up was not to fall into a false sense of complacency because in the future—I actually do not agree with Mr. Zandi. I think that inflation might be dormant, but it is not dead. And if it does come back, the windfall we have had—and a big part of this windfall has been lower debt service charges—we are going to lose that. That is why I focused on the supply side.

I fully support what the Federal Government in Canada did, which was, by the way, broaden the tax base—it comes down to tax expenditures. Broaden the base. And the Government of Canada broadened the base from, say, 70 percent to 85 percent of participants, and at the same time they lowered top marginal tax rates, which I think most economists—not all—would tell you that helps improve the incentive system.

Senator SESSIONS. Mr. Rosenberg, was there resistance to some of the fiscal restraints that were placed on spending during those years?

Mr. ROSENBERG. The spending cuts were dramatic, there is no question about it.

Senator SESSIONS. And did it hammer the Canadian economy? Was the economy in Canada permanently damaged? or is it healthier today as a result?

Mr. ROSENBERG. Not at all. It was controversial at the time. Now, this is basically important because this was not the conservative party that did this. It was the liberals who typically were center or left of center. But they could see that fiscal sustainability was being put into question.

Now, Canada ultimately did face a fiscal crisis in the early 1990s, and the government had to respond. And the answer to the question is that what the government did was they educated Canadians, comparing the fiscal budget to the household budget, living beyond your means, and it resonated because the liberals won two majority governments over the course of the next decade, so they never paid the political price. In fact, it became politically acceptable to have a lower level of government spending as a share of GDP in Canada and to have fiscal integrity.

Senator SESSIONS. Well, Mr. Rosenberg, one of the difficulties we have, in my opinion—and I think I am fair in saying this—is that the President refuses to even acknowledge that we have a deficit problem, and the Secretary of Treasury testified in this Committee that his budget would spend only money that we have and not add to the debt anymore, so it makes it difficult for the American people to be asked to sacrifice if their leaders are not doing it.

Now, let me ask you further, Canada has a much lower corporate tax rate. Would you say that if we eliminated some of the deductions or tax expenditures in the corporate world and used those savings to reduce corporate rates, this would help us a Nation have greater GDP growth?

Mr. ROSENBERG. I firmly believe that top marginal rates are very important. In Canada, the Federal Government cut top marginal rates on corporate income from 29 percent to 15 percent. When you look at the combined provincial-Federal, it is 26 percent in Canada; it is 40 percent in the United States. And the reality is that—and, again, I am taking a big-picture view here. I know we are talking about, you know, the debt ceiling, things that are coming up in the next 4 weeks, 8 weeks. I am taking a look at the next 4 to 8 years. We are talking about fiscal sustainability, because when you get to a situation where you are spending 20 cents of every revenue dollar on debt servicing, there is a significant problem, and that is a problem we are going to face under status quo.

In answer to your question, yes, I think corporate tax reform—and, actually, Canada is a great template. Canada today, on an equivalent basis to the United States, has a 5.7-percent unemployment rate in Canada today with a participation rate that is 3 percentage points higher. So if you are willing to take a long-term view, achieving fiscal sustainability and the certainty that imparts to the private sector is integral. I do not think anybody 20 years ago could have forecast that Canada today on an apples-to-apples basis would have a lower unemployment rate than is the case in the U.S.

Senator SESSIONS. Would the fact that we could get our Nation, as Canada has done, on a fiscal course that is not dangerous, would that help the economy grow by creating more confidence?

Mr. ROSENBERG. Absolutely. And Canada is a template. You know, if I go back, say, to the mid-1990s and you take a look at where Government spending was as a share of GDP in Canada, it was 20 percent. Today it is down to 15 percent. It has come down 5 percentage points.

Senator SESSIONS. And the economy has grown and unemployment is below the United States significantly.

Mr. ROSENBERG. That is correct.

Senator SESSIONS. Well, my time is up, but I do think that these are some of the long-term questions that we are wrestling with in Congress. Frankly, it is the disagreement, the good-faith disagreement between our parties mostly. Mr. Zandi believes we should spend more, borrow more, and tax more. So does Mr. Greenstein. And you do not, and I think I agree with you. Therein we have a disagreement.

Thank you, Madam Chair.

Chairman MURRAY. Thank you very much. And, Mr. Rosenberg, I just have to say I think all my constituents who want a Canadian-style health care would applaud how well Canada is doing as well.

Mr. ROSENBERG. Thank you.

Chairman MURRAY. Senator King?

Senator KING. Thank you.

Mr. Rosenberg, first, welcome to Washington and the U.S. I live in Maine where we can see Canada, generally.

[Laughter.]

Senator KING. And I do not know if you are aware of the definition of a Canadian. A Canadian is an unarmed North American with health insurance.

[Laughter.]

Mr. ROSENBERG. And a hockey stick in the other hand.

Senator KING. There you go.

Madam Chair, in reference to the budget, I think—and this takes off on Mr. Zandi's testimony—the passage of the budget agreement was miraculous because it did show that we could, in fact, do things. And I think it has already shown a positive effect on the economy.

I know it is miraculous because, in a hearing at the Armed Services Committee, we could not determine where the idea of reducing the COLA for military veterans came from, and I concluded that it was an immaculate conception, because it does not seem to have any parentage.

Gentlemen, I am worried about interest rates and the debt. And I think my friends on this side of the dais should be worried about it, too, because right now at a $17 trillion debt, if interest rates go to anything close to historic levels—call it 5 percent; in 2000 it was 6 percent—we are talking about $850 billion a year just to pay interest. That is larger than Social Security. That is a dead expense. And it is going to crowd out all the priorities that this side of the aisle wants to effectuate. It is bigger than Social Security. It is bigger than defense. It is 5 percent of GDP.

What do you think of the idea—I mean, we have done—I think we have done an incredible job of reducing the deficit from 9 percent of GDP to 3 percent. That is progress. But we have not done a thing about the debt itself. Do we need a mechanism to reduce the debt, some kind of 1 percent dedicated to debt reduction? In a home mortgage, it is when you put an extra $500 every month toward principal reduction. Otherwise, we will never get out of this hole, and I think we are facing a time bomb of interest rates. And an interest rate increase to 5 percent would make—I am trying to think of the sequester. Basically it would equal the sequester, if not greater.

Mr. Zandi, thoughts about that?

Mr. ZANDI. Well, I certainly sympathize with your concern. I would say a couple things to make you feel a little bit better. One is that in the budget forecast, the CBO budget forecast, they project a normalization of interest rates, so 10-year Treasury yields go back closer to that 5-percent rate that you mentioned. And—

Senator KING. That makes me feel better?

Mr. ZANDI. Well, in the sense that—

Senator KING. That gets us to $850 billion a year of interest payments.

Mr. ZANDI. In the sense that even with that interest rate assumption, which is a very reasonable assumption, the deficit-to-GDP ratio remains low, at least through the remainder of the decade.

The other thing I—

Senator KING. The deficit or the debt.

Mr. ZANDI. Both. Both. The deficit to GDP will remain stable at 3, 3–1/2 percent of GDP, and the debt-to-GDP ratio will remain constant at 73, 74 percent for the next 5 years or so.

The other reason to be a little sanguine in the near term is that the Treasury is also extending the maturity of the debt, so the average maturity of the debt is almost 6 years, so they are locking in these low interest rates for a while. But you make a great point. As you move out into the next decade, we have got rising entitlement costs and rising interest costs, and it does not work. Our fiscal situation will fall apart. So we need to address that.

But the way to address that is through blocking and tackling. You know, we have got to reform the entitlement programs to put them on a sustainable basis. That means more work on health care at some point. And it also means tax reform and generating more tax revenue. There will be more baby boomers retiring needing Social Security and Medicare, and we need more tax revenue to meet that demand.

So there is no easy answer that, you know, we pay back the debt one dollar—without addressing spending, without addressing the Tax Code. We have to do those things to address the debt.

Senator KING. We have to do all three of those things. But my question, Mr. Greenstein, is: Don't we need to be thinking about that $17 trillion and how we get it down to 10 or some number where 1 point of the interest rate does not equal $170 billion a year?

Mr. GREENSTEIN. A couple of points. Our key figure is really the roughly $12 trillion that is the debt held by the public. The other roughly $5 trillion is debt one part of Government owes another part of Government, and the interest is just sort of moving between accounts within the Government.

But the $12 trillion, which is the publicly held debt, is a concern, and the concern is that over the long term, if the debt keeps rising as a share of the economy and, as you say, interest rates come back to more normal levels, then I think all three of us are saying that the total amount the Government has to pay out in interest each year is too high. It probably both makes our fiscal situation less good and crowds out other things that are important to do.

So the issue, I think, is not actually lowering that dollar amount. You know, let us suppose that magically you could keep the publicly held debt from not rising too much above $12 trillion. Your debt would come way down over time as a share of GDP as the economy grew.

I think we kind of see as the goal, first, stabilize the debt so it does not rise faster than GDP, and then as Mark Zandi said, over time we want to get that debt ratio down. We have made more progress than people understood. "We, the Committee for a Responsible Federal Budget. 4 years ago, were predicting debt-to-GDP ratios of 200 to 300 percent of GDP out 30 or 40 years. Now it looks like it is below 100 percent of GDP. Still too high. We have got to get it down lower. But I think the lesson to me of the last few years is it is politically very hard to do grand bargains, but if we keep chipping away incrementally, we can make progress, first, to stabilize the debt and then to put it on a downward path. And, of course, the single most important variable here, what happens to the rate of growth of health care costs throughout the entire U.S. health care system?

Senator KING. I missed your initial testimony. I apologize. I was at another hearing. But are there any good theories about why the health care costs have, in fact, fallen, the growth has fallen in the last 2 or 3 years? Is it sustainable? I guess that is the real question.

Mr. GREENSTEIN. That is the $64,000 question. I think the—

Senator KING. It is in the billions, Mr. Greenstein.

Mr. GREENSTEIN. I am showing my age. I watched that quiz show as a kid.

I think there is broad agreement among analysts that some of the slowdown is due to the economy—less consumer demand affects purchases for health as well—but then a lot of it is due to changes in the health care system. If it were purely the economy, we would not see a big effect in the slowdown in cost growth per beneficiary in Medicare, since Medicare beneficiaries are generally out of the economy.

With each new year of data, analysts are getting more encouraged that a larger share of this may be ongoing rather than temporary. We do not know yet, and there is a lot of ferment going on in the private sector, in demonstration projects throughout the country in Republican and Democratic States alike. States are experimenting with things like better coordinating care for Medicare-Medicaid dual eligibles. The hope is that much of this remains. There are new developments that slow cost growth and that we get results from research and demonstration projects that point out the next set of things to do. But that is part of the uncertainty. There is a wide range of uncertainty now on how much health care costs will slow on an ongoing basis in future decades. And if you are at the low end of the spectrum, the fiscal situation is no longer that dire in future decades. But if you are at the high end of the situation, it is a disaster in future decades. And we do not know yet where in that range we are.

Senator KING. I am out of time. I certainly appreciate your testimony and would commend to you three gentlemen to think about is there some mechanics whereby we can not only reduce the deficit but also make a credible reduction of the debt itself, for example, tax reform, part of the new revenues go to lowering rates, but part goes to debt reduction—not deficit reduction but debt reduction. It is just an idea, and I would ask you to think about that. If you have thoughts, pass them on. Thank you.

Thank you, Madam Chair.

Chairman MURRAY. Thank you.

Senator Johnson?

Senator JOHNSON. Thank you, Madam Chair.

I will just quickly give a business person's perspective of one of the reasons that health care costs are restrained is over 31 years, as I bought health insurance for the people who worked with me, as we went to higher and higher deductibles, instituted health savings accounts, that put people in charge and involved in the consumer's decisions. I think that has certainly had an impact.

One thing I would like to do is I do have one slide. You know, as a manufacturer, I certainly learned how to solve problems. The first step in solving a problem is to admit you have got one. The second step is to properly define it.

Now, what we have tried to do—and CBO has been somewhat helpful, but not as helpful as I would like them to be, but we have used their alternate scenario here, which is really, if you take a look at the assumptions here, pretty reasonable: tax cuts for people making less than $250,000 continue, and we basically enacted that; AMT patches, doc fixes, all these things continue.

As we have taken their percentage of GDP figures—which is incomprehensible. I mean, I am sorry, we all talk about it, but nobody understands it—and tried to turn that into dollars, what we have come up with is about $100 trillion of deficit spending over the next 30 years. Now, 30 years is not a very long time period. My eldest child just turned 30. It went by in a heartbeat.

We do not have a 10-year budget window problem. You can see that. The deficit over the next 10 years is about $5 trillion. We have a 30-year demographic problem. We have a bunch of baby boomers retiring at the rate of 10,000 per day. We have made all these promises to them, and we did not make adequate provision to pay them. And that puts us in a real pinch.

So if you take a look at—what I have tried to do is do this 30-year projection—and I know, Senator King, I appreciate you are willing to hear me out on this. We have tried to set up in a format where we are not dealing with that many numbers, but we are dealing with numbers so people can understand it. I think people can take a look at this and go, boy, $100 trillion, by the way, that exceeds the net private asset base of the United States today.

But you can also kind of see where the problem lies. You have got about $14, $15 trillion in Social Security benefits that exceed what we take in the payroll tax. You have got about $35 trillion of Medicare payments, benefits, that exceed what we take in the payroll tax, and the rest is just other deficit spending, if you want to define it that way. So, you know, from my standpoint I would like to start with a couple questions.

Mr. Rosenberg, you were talking about labor force participation and talking about educating the public. I could not agree more with you. Very interesting that Canada limits their—right now their spending in relationship to GDP is 15 percent. Ours peaked over the last couple of years at 25 percent, not historically peaked but in the relatively short term 25 percent. We are down to 20, but we are on a trajectory to hit 30, 35 percent, depending on what projections you are looking at.

You quote—and I am also aware of the fact that in the last 5 years we have gone from people out of the workforce, from about 81 million to 92 million, increasing 11 million individuals. Now, some of those are those retiring baby-boom generation. Do you have that broken down at all? Have you ever seen where that breaks down? How many are retiring? How many should potentially be in the workforce?

Mr. ROSENBERG. Well, I do not have the numbers broken down, but the data from the BLS, from the household survey, are fairly detailed. So the data are not that difficult to obtain. But I think that when you take a look—and what I said before, that even if you take a look at the prime aged adult cohort, say that 25-to 54-year cohort, people have been leaving the labor force there as well. Those are not retirees. And I think the one area where I would disagree with Mark Zandi is that this is not about discouraged workers. That is what is incredible, is that in the prime aged cohort, the number of people that have left the labor force that say they are discouraged are actually down 20 percent. There is something else at work here.

Senator JOHNSON. We had an incredibly interesting witness here, the head of the welfare department of Pennsylvania, and he did a study on a single mom, who we have got a great deal of sympathy for. But he showed that basically up to $26,000 of earnings it was marginally beneficial for her to continue to work. Past that point, because of a decrease in benefits and an increase in taxes, she basically was facing a marginal tax rate of 100 percent until her earnings got into the $60,000 range.

Have you seen studies and could it be one of the reasons people are leaving the labor force, is we incentivize them not to work at a certain point?

Mr. ROSENBERG. Well, there have been studies, some rather controversial, which have shown that, you know, if you do tap the myriad of benefits at every level of Government, you can actually—in 39 States apparently you could make as much money, say, as an admin assistant. Now, as I said, these—you know, this report in particular was controversial. I cited in the written testimony that I handed in a report, testimony by C. Eugene Steuerle in

February of last year to the House Committee on Oversight and Government Reform. It was titled—and I think this is well worth the read for everybody. It was called "Labor Force Participation, Taxes and the Nation's Social Welfare System." And he did basically discuss some of the plausible explanations as to why people are falling through the cracks of the labor market as traditionally defined.

Basically one of the things that should be examined, at least is his conclusion, was the piecemeal and inefficient manner that a lot of these, say, Government subsidies are being introduced. That is one thing that the Canadian Government did at the same time. They did a whole bunch of things back in the mid-1990s. But they unbundled a lot of these social programs to make them more targeted, and in the final analysis saved taxpayer money.

Senator JOHNSON. Senator Sessions talked about making a modification to the earned income tax credit, which I believe is the best way of addressing a livable wage so that we do not actually reduce the entry-level job positions, because I think that is what happens when you increase the minimum wage.

Another thing we take a look at in terms of strengthening that is let us work to eliminate the 21 percent of improper payments in the earned income tax credit. That is one way we can strengthen it.

Before I run out of time, I do want to just touch on Social Security. I think, Mr. Greenstein, you talked about the difference between public debt and total debt, and that really does speak to the trust funds. We had very interesting testimony from CBO Director Elmendorf in our budget conference where finally, after four attempts with administration officials, I was able to get Mr. Elmendorf to admit that the Social Security Trust Fund nets to zero when you consolidate the books of the Federal Government. You have an asset in the Social Security Trust Fund offset by the liability to the Treasury netting to zero.

And so when you take a look at these deficits, when you realize that you really have no asset, no real asset of the Federal Government to pay off $14, $15 trillion in Social Security, that is a real problem, isn't it?

Mr. GREENSTEIN. Well, it is part of their larger long-term fiscal imbalance. The Social Security Trust Fund holds Treasury bonds that investors worldwide view as perhaps the safest investment in the world. So Social—

Senator JOHNSON. But when it is held in the hands of the Federal Government, it is the same thing as if you had $20, spent it, and then write yourself a pretty little note, put it in your pocket, and say, "I have got 20 bucks." No. You have a piece of paper that you are going to have to get somebody else to give you money, either tax people or get somebody else to buy that bond. Correct?

Mr. GREENSTEIN. It is as good as gold for Social Security. It is not sufficient for Social Security for the next 75 years. That is why the system is projected to become insolvent in about 2033. But part—

Senator JOHNSON. So who pays, who reimburses the trust fund for the $2.6 trillion?

Mr. GREENSTEIN. This is part of our larger governmentwide fiscal imbalance that we need to address.

Senator JOHNSON. It is the Federal Government that has to pay the $2.6 trillion, right? So it has got the liability, the asset; it has no value to the Federal Government. I just want people to understand, to define the problem, admit we have one, because Social Security is not solvent to the year 2033. It is running cash deficits now. It will run cash deficits of $4 to $5 trillion over the next 30 years, and we better fix that. And Medicare is even worse, a dollar going in, $3 being paid out in benefits, and, you know, around this town nobody is—we basically have reality deniers here. Nobody is admitting we have a problem. We are not defining it properly. We are talking all these percentages and gobbledygook. We need to put some real hard numbers. We have got to have the solutions laid out with the dollar value of those solutions so we start talking about and debating these issues with real information. That is my point.

Mr. GREENSTEIN. I would just say two things can simultaneously be true, and this is not a contradiction:

Social Security is solvent through the early 2030s because it has these assets which will absolutely be honored. If the Federal Government stopped honoring Treasury bonds, whether they were held by U.S. investors, foreign investors, or the Social Security Trust Fund, any one of the three, that would have catastrophic implications.

But it is also true, as you are saying, that the overall Federal balance sheet that includes Social Security has to be stable, and to do that we have to have a debt-to-GDP ratio at a sustainable level that is not rising rapidly.

Chairman MURRAY. Mr. Greenstein, that is going to have to be our last word, and I appreciate all of our witnesses for participating today, and I want to thank all of our colleagues as well.

As I said at the outset, I really hope that the passage of our Bipartisan Budget Act really signals the beginning of the end of Congress lurching from these manufactured crises to the next and serves as a model of how we can all work together on issues that expand opportunity and growth for our families and our communities and our businesses.

With that, as I mentioned earlier today, we will be here again next Tuesday to hear from Director Doug Elmendorf on CBO's latest budget and economic outlook. I urge all of our colleagues to attend that important hearing.

And, finally, as a reminder, additional statements and/or questions for our witnesses from today's hearing are due in by 6:00 p.m. today.

With that, thank you all for your participation, and this hearing is closed.

[Whereupon, at 12:09 p.m., the Committee was adjourned.]

# THE BUDGET AND ECONOMIC OUTLOOK FOR FISCAL YEARS 2014–2024

**TUESDAY, FEBRUARY 11, 2014**

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
*Washington, D.C.*

The Committee met, pursuant to notice, at 10:34 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Nelson, Stabenow, Whitehouse, Warner, Coons, Baldwin, Kaine, King, Sessions, Grassley, Enzi, Crapo, Portman, Toomey, Johnson, Ayotte, and Wicker.

Staff Present: Evan T. Schatz, Majority Staff Director; and Eric M. Ueland, Minority Staff Director.

## OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. This hearing will come to order. I want to welcome everyone and thank my Ranking Member, Senator Sessions, and all of our colleagues who are joining us here today.

And I want to thank Dr. Doug Elmendorf and the entire staff at the Congressional Budget Office. We really do appreciate all the hard work and the high standard of professionalism and objectivity that CBO provides to this Committee and to Congress. Those qualities were especially helpful last year in assisting Chairman Ryan and I with the completion of the 2-year Bipartisan Budget Act.

That deal that we reached in December was a strong step away from the constant crises that we have seen for the past few years. Democrats and Republicans finally came together to pass a budget and roll back the irresponsible cuts from sequestration with a balanced approach that included smarter savings and new revenue. And we came together and compromised to show people everywhere that bipartisan work in Washington is possible.

Unfortunately, the drama and uncertainty around the debt limit that caused so much harm to families and the economy last year has come back over the past few weeks. But there was encouraging news this morning. House Republicans seem to have finally realized that Democrats are not going to pay a ransom to allow the Federal Government to pay its bills, and I look forward to them sending over a debt limit bill with no ransom demands attached. And I am hopeful that we can truly step away from the constant crises and debt limit brinkmanship to build on the bipartisan progress that we did make in our budget deal.

Now, recognizing the findings and the challenges that the CBO budget outlook identified, I think we should move forward in two ways. First, we need to work to ensure every family has the opportunity to succeed in America. At the same time, we need to address our long-term fiscal challenges fairly and responsibly.

Those two goals go hand in hand because the best way to tackle our long-term fiscal challenges is to invest in broad-based and long-term economic growth.

Before we get into the details of the CBO's outlook for the next decade, it is helpful to take a step back and see where we have been.

When President Obama took office, we were facing the worst economic downturn since the Great Depression. The country was losing more than 700,000 jobs a month. Families were losing their homes, and parents were losing confidence in what the future would be like for their children.

We have made significant progress since then. We have had 47 consecutive months of private sector job gains. Economists believe economic growth is poised to accelerate this year. The housing market has improved, though we cannot forget that many families are still struggling. And, of course, even though these are good signs, the recovery has not been nearly as fast, or as strong, as any of us would like. Last Friday's disappointing jobs report is just the latest reminder of that. So while we are moving in the right direction, Congress can, and must, do more to boost this economic recovery.

In the past few years, we have also made significant strides in tackling our fiscal challenges. Since 2009, we have cut our deficit in half. CBO projects it is on a path to decline further this year and the next, with the debt stabilized as a share of the economy through the end of this decade.

But as with the economic recovery, we have more work to do, and I look forward to hearing from Dr. Elmendorf about the long-term deficit challenges—challenges we cannot ignore.

To be clear, discretionary spending—by which I mean investments in priorities like national security and infrastructure, research, education, and programs that fight poverty and provide economic security—that is not driving our fiscal challenges.

In fact, CBO projects that discretionary spending will continue to decline as a share of GDP through 2024. In the 1970s and 1980s, discretionary spending averaged about 10 percent of GDP. Last year, it was at 7.2 percent of GDP. And by 2024, those investments will represent just 5.2 percent of GDP. This decline is alarming because limiting discretionary spending means limiting investments in innovation and cutting-edge technology that actually spark job growth. It also means threatening our efforts to care for service members, veterans, and their families. Those lifetime investments will be critical over the next few years as more military families transition from the battlefront to the home front.

And limiting discretionary spending will roll back efforts to give kids and families the education and job training opportunities that they need to succeed in a global economy.

I want to be clear on another point in the CBO report that caused a lot of confusion last week. For too long in this country, leaving a job also meant leaving behind your health care coverage. In 2008, Harvard University conducted a study that found 11 million workers wanted to change jobs, but felt locked in to their current job simply to keep their insurance.

One of those workers is named Christine Lange. She is from my home State of Washington, and a year ago, Christine dreamed of quitting her job to start a small business. But her family relied on the health insurance that she received through her employer.

The Affordable Care Act changed that for her. In January, she retired from her old job and now plans to launch her own business later this year.

By expanding access to health care, more people will also have the opportunity to retire early. More entrepreneurs will have the chance to start a new business, without giving up access to health care.

And CBO's report makes it clear that the Affordable Care Act is good for parents. That is because it will give more parents the choice to stay home and raise a family and the choice to reduce hours to take care of an aging parent or family member.

That does not mean that unemployment will go up. In fact, CBO found that, on balance, the Affordable Care Act will actually boost demand for goods and services over the next few years. And that is because when people have access to affordable health care, they are able to spend more of their earnings on other family needs.

But the latest outlook makes clear we have some areas to work on. The CBO projects mandatory spending for programs like Medicare and Medicaid will continue to rise over the next decade. The solution is not to shift those growing costs onto seniors and families, as we have heard Republicans propose. We need to work on ways to bring those costs down responsibly.

The good news is health care costs have slowed significantly in recent years. From 2010 to 2012, the cost of health care grew at its slowest pace since the Government started tracking it in the 1960s, according to the Council of Economic Advisers. The CBO reports the cost of Medicare "will be slower than usual for some years to come."

So we need to follow through on the reforms in the Affordable Care Act that reduce costs and increase access to quality care. And we need to work together to build on them.

Bringing down health care costs is just one part of the solution. We also need a balanced approach to tackle our deficit—one that reduces spending and raises new revenue fairly and responsibly.

As CBO reports, in 2014, Federal spending through the Tax Code is the single largest item in the budget, costing American taxpayers more than Social Security, Medicare, or defense.

While some of those tax breaks go to important investments in the middle class and low-income working families, the Treasury loses hundreds of billions of dollars to tax loopholes and carve-outs that benefit the wealthiest Americans and biggest corporations.

Big businesses should not get to write off expenses associated with shutting down a plant in the U.S. and moving it overseas. It is wrong that corporations can claim massive tax breaks by deducting the interest on loans used to finance foreign operations before they pay tax on their foreign income.

These unfair tax giveaways only incentivize corporations to move jobs abroad, and they make it harder for U.S. businesses without foreign operations to compete.

The list of egregious loopholes and special interest giveaways goes on, and it would be unfair and unacceptable to protect every last one of them and ask seniors and families to bear the burden of deficit reduction alone.

In recent years, many in Congress have had almost a singular focus on reducing the budget deficit. While important, that has left us with deeper deficits in other areas.

Our roads and bridges are crumbling. We are not making the investments we need in education and job training. While other nations are investing in innovation and research and development, we have scaled them back. We have a serious jobs deficit and a serious opportunity deficit. And we would be doing families today, and the next generation, a great disservice if we let these deficits continue to grow.

Addressing these deficits is not just the right thing to do. It is also good economics, and it is good for the budget. When we invest in job creation and innovation, small business owners create new products and technology the rest of the world wants to buy. And with more growth, more people can find jobs, and incomes increase. As broad-based prosperity increases, our long-term budget challenges become easier to tackle.

That point—that these two challenges go hand in hand—is riveted by the latest CBO report. As I read it, Dr. Elmendorf, the biggest change in the deficit and debt projections relative to last May result from changes in CBO's economic projections. Those changes lower revenues and, on net, increase deficits and debt by $1.2 trillion.

To put that in perspective, $1.2 trillion is twice the amount of revenue that Congress elected to raise by allowing a portion of the 2001 and 2003 tax relief to expire for upper-income taxpayers at the end of the last Congress.

So we need to put in place a credible plan that reduces spending responsibly, that raises revenue by closing wasteful and egregious tax loopholes, and that invests in and grows our economy today and pays dividends for generations to come.

But to do that, we will have to build on the bipartisan foundation we built with our 2-year budget deal. That deal was a good start. It showed that Republicans and Democrats can come together to put families and the economy first.

I hope continue that work and tackle our long-term fiscal challenges fairly and responsibly and expand opportunities for our workers and our families, because I think if we do that, we can move forward together and build a future of shared prosperity for generations to come.

With that, Dr. Elmendorf, I am looking forward to hearing your remarks, but first we will hear from my colleague Senator Sessions.

## OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you, Madam Chairman, and welcome, Director Elmendorf. We want to thank you and your team for the good work and support you give to Congress.

The Ryan-Murray bill did, Madam Chairman, create some stability in our fiscal situation, which is good, but it did spend more money than was agreed to in the Budget Control Act. And this very day we will be voting again to bust the limits you placed in Ryan-Murray. So this Congress is not showing in any real sense a commitment to honor the promises we make to the American people, and that is one of the reasons our debts have reached such a high level.

CBO's latest budget and economic outlook is another sobering report in a number of sobering reports since the 2007–09 recession. It has been 4 years since that recession, long past the time we normally see more robust growth than we are now recognizing. And the CBO report indicates that in the tenth year, the amount of interest we would pay on our debt just that year is higher than you projected last year after 10 years. It is not a good path.

So the Nation's policies after the recession ended in 2009 have not come close to producing the results, the growth the President promised. CBO and many other organizations, the President's own OMB, and the Federal Reserve have also made forecasts for economic growth that were far above what actually happened. CBO's report today is a recognition that the economy has failed to lift off after the recession had been declared over.

Millions of Americans are hurting. This is not a healthy recovery. It is just not. The United States economy typically reverts to the mean after a recession, but this time it has not. The President has said his stimulus bill, the Affordable Care Act, increased taxes and regulations, and more Government spending would result in a strong bounce-back. But after President Obama signed the stimulus bill, the Congressional Budget Office estimated that real GDP growth would be at 4.7 percent for each of the past 2 years. That is 2012 and 2013. We did not have that growth. It grew at a paltry 1.9 percent last year, falling from an anemic 2.8 percent the year before.

Only 2 years ago, after the Affordable Care Act was passed, CBO expected real growth this year, 2014, to be 4.6 percent. Wouldn't we like to have that? After these misses, CBO is now predicting we would have only 2.7 percent growth this year.

Ominously, the percentage of people participating in the economy, working or looking for work, the labor force participation rate has fallen to 1970s levels.

So the policies that the Nation has pursued to promote economic growth, they have not had the effect we hoped for. The growth that is needed to increase the number of Americans with jobs did not occur. The recovery to date has seen corporate profits increase some and the wealthy to see their investments grow at least close to what they were before the recession. But working Americans have seen lower wages, more part-time jobs, and fewer full-time jobs.

It is clear that growth at 2 percent is merely treading water. It must be sharply higher to increase the number of Americans actually working. Certainly we have learned in this recovery that GDP growth can occur without real benefits for the working people in our country. And, sadly, CBO's report also recognizes that the

President's 2010 health care law is a hammer blow to lower-income workers.

Despite concerns raised at the time that the Affordable Care Act would reduce work opportunities, CBO did not think that effect would be significant when the law was signed in 2010. CBO now estimates Obamacare will lead to Americans working fewer hours or dropping out, and this will be the equivalent of 2.5 million productive Americans. In other words, 4 years after the health care law was enacted and just as it is beginning to be implemented, CBO has now tripled its estimate of the number of jobs that will be lost or equivalent jobs that will be lost as a result of the law. So that means the average employed person's wages will total $930 less 10 years from now.

CBO has been criticized for this finding, but the analysis you have made, Dr. Elmendorf, it seems to me just reflects what data is showing. Indeed, two-thirds of jobs created in 2013 were part-time jobs. So I look forward to receiving from CBO more information about how these conclusions were derived. We do know this compensation loss will fall more heavily on lower-income Americans.

So this is another example of the policies with good intentions that are actually hurting working Americans, not helping them. The end result is that CBO has reduced its estimate of the economy's growth potential, and the report finds the U.S. economy is not assumed to reach even that reduced potential over the next 10 years under current policies.

So let us pause a minute to consider an important point, as stated by the free market-oriented National Review. They declare, rightly I think, that we are a nation with an economy, not an economy with a nation. It is our duty to take principled, achievable steps that will benefit the most Americans in our country, not just the fortunate few, and to do so without increasing our debt, which is already well into the danger zone.

So I hope the CBO's report and today's decision can help serve as a springboard for a more serious conversation about what is going on in the U.S. economy and the people who have not prospered.

Spend, borrow, regulate, and tax have not worked as a jump-start to prosperity. Expanding Government has not produced prosperity. Stimulus programs and quantitative easing have done little good. Indeed, these actions reality shows overall have produced far weaker growth than was predicted even just a few years ago, and which we normally see after a recession.

So working Americans should focus less on promises and good intentions. They need to focus more on results and what will actually happen. That is what we in Congress should do. Good intentions are not sufficient. We need to enact sound policies that reduce the deficits and put us on a path to growth and prosperity.

I thank you for your report, Dr. Elmendorf, and look forward to working with you as we go forward.

Chairman MURRAY. Thank you.

Dr. Elmendorf, I understand that your microphone is not working, so we have jury-rigged something for you. It is probably unfortunate that our microphones did not blow out. But be as it is, I hope that that one works well for you and we can move forward with your testimony.

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

Mr. ELMENDORF. So I hope this will be fine. Thank you, Chairman Murray, Senator Sessions, and members of the Committee. On behalf of all of my colleagues who have worked so hard to produce these reports on the outlook for the budget and the economy and on the slow recovery of our labor market, I am happy to be here today.

Beginning with the budget, the Federal budget deficit has fallen sharply during the past few years, and it is on a path to decline further this year and next year. We estimate that, under current law, the budget deficit this year will total about $500 billion compared with $1.4 trillion in 2009. At that level, this year's deficit would equal about 3 percent of the Nation's economic output or GDP, close to the average percentage seen during the past 40 years.

As you know, our baseline projections show what we think would happen to Federal spending, revenues, and deficits over the next 10 years if current laws generally were unchanged. Under that assumption, the deficit is projected to decrease again in 2015 to about 2.5 percent of GDP. After that, however, deficits are projected to start rising, both in dollar terms and as a share of the economy, because revenues are expected to grow at roughly the same pace as GDP, whereas spending is expected to grow more rapidly than GDP.

Why the more rapid spending growth? In our baseline, spending is boosted by four factors: the aging of the population, the expansion of Federal subsidies for health insurance, rising health care costs per beneficiary, and mounting interest payments on Federal debt.

With no changes in the applicable laws, spending for Social Security will increase from about 5 percent of GDP this year to about 5.5 percent in 2024. Spending for the major health care programs, a category that includes Medicare, Medicaid, the Children's Health Insurance Program—or CHIP—and subsidies to be provided through insurance exchanges, will climb from less than 5 percent this year to more than 6 percent in 2024 under current laws. And net interest payments by the Federal Government are also projected to grow rapidly, primarily because interest rates are likely to return to more typical levels.

In sharp contrast, the rest of the Federal Government's non-interest spending for defense, for benefit programs other than the ones I just mentioned, and for all other non-defense activities is projected to drop from about 9.5 percent of GDP this year to about 7.5 percent in 2024 under current law. That would be the lowest percentage of GDP since at least 1940, which is the earliest year for which comparable data have been reported. Thus, an increasing share of the budget would go toward benefits from a few large programs, and a shrinking share would go toward most of the rest of the Government's functions.

The large budget deficits recorded in recent years have substantially increased Federal debt, and the amount of debt relative to the size of the economy is now very high by historical standards. We estimate that Federal debt held by the public will equal 74 percent of GDP at the end of this year and under current law will reach 79 percent in 2024. Such large and growing Federal debt could have serious negative consequences, including restraining economic growth in the long term, giving policymakers less flexibility to respond to unexpected challenges, and eventually increasing the risk of a fiscal crisis in which investors would demand high interest rates to buy the Government's debt.

Turning to the economy, we expect that, after a frustratingly slow recovery from the severe recession of 2007–09, the economy will grow at a solid pace for the next few years, but will continue to have considerable unused labor and capital resources, or "slack."

Further growth in housing construction and business investment should raise output and employment, and the resulting increase in income should boost consumer spending. In addition, under current law, the Federal Government's tax and spending policies will not restrain economic growth this year to the extent they did last year. And the State and local governments are likely to increase their purchases of goods and services, adjusted for inflation, after having reduced them for several years. As a result, our baseline shows inflation-adjusted GDP expanding more quickly from 2014 to 2017—at an average rate of roughly 3 percent a year—than it did in 2013.

We expect that those increases in output will spur businesses to hire more workers, pushing down the unemployment rate and tending to raise the rate of participation in the labor force, as some discouraged workers return to the labor force in search of jobs. That effect on participation will keep the unemployment rate from falling as much as it would otherwise. We project that the unemployment rate will decline only gradually over the next few years, finally dropping below 6.0 percent in 2017, and then edging down further after that.

Nevertheless, the labor force participation rate is also projected to decline further in the next few years because, according to our analysis, the increase in participation stemming from improvements in the economy will be more than offset by downward pressure from demographic trends, especially the aging of the baby-boom generation.

After 2017, when the demographic trends will still be unfolding but the effects of cyclical conditions will, we expect, have largely waned, the participation rate is projected to decline more rapidly. That is the main reason why beyond 2017 we project that economic growth will diminish to only a bit more than 2 percent per year, a pace that is well below the average seen over the past several decades.

Thank you. I am happy to take your questions.

[The prepared statement of Mr. Elmendorf follows:]

Congressional Budget Office

# Testimony

# The Budget and Economic Outlook: 2014 to 2024

**Douglas W. Elmendorf**
**Director**

**Committee on the Budget**
**United States Senate**

**February 11, 2014**

*This document is embargoed until it is delivered at 10:30 a.m. (EST) on Tuesday, February 11, 2014. The contents may not be published, transmitted, or otherwise communicated by any print, broadcast, or electronic media before that time.*

Chairman Murray, Senator Sessions, and Members of the Committee, thank you for inviting me to testify on the Congressional Budget Office's (CBO's) most recent analysis of the outlook for the budget and the economy. My statement summarizes CBO's new economic forecast and baseline budget projections, which cover 2014 to 2024. Those estimates were released last week in the report titled *The Budget and Economic Outlook: 2014 to 2024*.

The federal budget deficit has fallen sharply during the past few years, and it is on a path to decline further this year and next year. The Congressional Budget Office (CBO) estimates that under current law, the deficit will total $514 billion in fiscal year 2014, compared with $1.4 trillion in 2009. At that level, this year's deficit would equal 3.0 percent of the nation's economic output, or gross domestic product (GDP)—close to the average percentage of GDP seen during the past 40 years.

As it does regularly, CBO has prepared baseline projections of what federal spending, revenues, and deficits would look like over the next 10 years if current laws governing federal taxes and spending generally remained unchanged. Under that assumption, the deficit is projected to decrease again in 2015—to $478 billion, or 2.6 percent of GDP (see Table 1). After that, however, deficits are projected to start rising—both in dollar terms and relative to the size of the economy—because revenues are expected to grow at roughly the same pace as GDP whereas spending is expected to grow more rapidly than GDP. In CBO's baseline, spending is boosted by the aging of the population, the expansion of federal subsidies for health insurance, rising health care costs per beneficiary, and mounting interest costs on federal debt. By contrast, all federal spending apart from outlays for Social Security, major health care programs, and net interest payments is projected to drop to its lowest percentage of GDP since 1940 (the earliest year for which comparable data have been reported).

The large budget deficits recorded in recent years have substantially increased federal debt, and the amount of debt relative to the size of the economy is now very high by historical standards. CBO estimates that federal debt held by the public will equal 74 percent of GDP at the end of this year and 79 percent in 2024 (the end of the current 10-year projection period). Such large and growing federal debt could have serious negative consequences, including restraining economic growth in the long term, giving policymakers less flexibility to respond to unexpected challenges, and eventually increasing the risk of a fiscal crisis (in which investors would demand high interest rates to buy the government's debt).

After a frustratingly slow recovery from the severe recession of 2007 to 2009, the economy will grow at a solid pace in 2014 and for the next few years, CBO projects. Real GDP (output adjusted to remove the effects of inflation) is expected to increase by roughly 3 percent between the fourth quarter of 2013 and the fourth quarter of 2014—the largest rise in nearly a decade. Similar annual growth rates are projected through 2017. Nevertheless, CBO estimates that the economy will continue to have considerable unused labor and capital resources (or "slack") for the next few years. Although the unemployment rate is expected to decline, CBO projects that it will remain above 6.0 percent until late 2016. Moreover, the rate of participation in the labor force—which has been pushed down by the unusually large number of people who have decided not to look for work because of a lack of job opportunities—is projected to move only slowly back toward what it would be without the cyclical weakness in the economy.

Beyond 2017, CBO expects that economic growth will diminish to a pace that is well below the average seen over the past several decades. That projected slowdown mainly reflects long-term trends—particularly, slower growth in the labor force because of the aging of the population. Inflation, as measured by the change in the price index for personal consumption expenditures (PCE), will remain at or below 2.0 percent throughout the next decade, CBO anticipates. Interest rates on Treasury securities, which have been exceptionally low since the recession, are projected to increase in the next few years as the economy strengthens and to end up at levels that are close to their historical averages (adjusted for inflation).

## Deficits Are Projected to Decline Through 2015 but Rise Thereafter, Further Boosting Federal Debt

Assuming no legislative action that would significantly affect revenues or spending, CBO projects that the federal budget deficit will fall from 4.1 percent of GDP last year to 2.6 percent in 2015—and then rise again, equaling about 4 percent of GDP between 2022 and 2024. That pattern of lower deficits initially and higher deficits for the rest of the coming decade would cause federal debt to follow a similar path. Relative to the nation's output, debt held by the public is projected to decline slightly between 2014 and 2017, to 72 percent of GDP, but then to rise in later years, reaching 79 percent of GDP at the end of 2024. By comparison, as recently as

**Table 1.**

## CBO's Baseline Budget Projections

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | In Billions of Dollars | | | | | | | |
| Revenues | 2,774 | 3,029 | 3,305 | 3,481 | 3,631 | 3,770 | 3,932 | 4,104 | 4,288 | 4,490 | 4,702 | 4,926 | 18,120 | 40,630 |
| Outlays | 3,454 | 3,543 | 3,783 | 4,020 | 4,212 | 4,425 | 4,684 | 4,939 | 5,200 | 5,522 | 5,749 | 6,000 | 21,124 | 48,534 |
| **Deficit (-) or Surplus** | **-680** | **-514** | **-478** | **-539** | **-581** | **-655** | **-752** | **-836** | **-912** | **-1,031** | **-1,047** | **-1,074** | **-3,005** | **-7,904** |
| On-budget | -720 | -553 | -504 | -555 | -583 | -641 | -719 | -775 | -821 | -907 | -886 | -871 | -3,001 | -7,261 |
| Off-budget[a] | 40 | 38 | 26 | 16 | 2 | -14 | -34 | -61 | -91 | -124 | -160 | -203 | -3 | -642 |
| Debt Held by the Public at the End of the Year | 11,982 | 12,717 | 13,263 | 13,861 | 14,507 | 15,218 | 16,028 | 16,925 | 17,899 | 19,001 | 20,115 | 21,260 | n.a. | n.a. |
| | | | | | | | As a Percentage of Gross Domestic Product | | | | | | | |
| Revenues | 16.7 | 17.5 | 18.2 | 18.2 | 18.1 | 18.0 | 18.0 | 18.0 | 18.1 | 18.1 | 18.2 | 18.4 | 18.1 | 18.1 |
| Outlays | 20.8 | 20.5 | 20.9 | 21.1 | 21.0 | 21.1 | 21.4 | 21.7 | 21.9 | 22.3 | 22.3 | 22.4 | 21.1 | 21.7 |
| **Deficit** | **-4.1** | **-3.0** | **-2.6** | **-2.8** | **-2.9** | **-3.1** | **-3.4** | **-3.7** | **-3.8** | **-4.2** | **-4.1** | **-4.0** | **-3.0** | **-3.5** |
| Debt Held by the Public at the End of the Year | 72.1 | 73.6 | 73.2 | 72.6 | 72.3 | 72.6 | 73.3 | 74.2 | 75.3 | 76.8 | 78.0 | 79.2 | n.a. | n.a. |

Source: Congressional Budget Office.

Note: n.a. = not applicable.

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

the end of 2007, such debt equaled 35 percent of GDP (see Figure 1).

### Revenues

Federal revenues are expected to grow by about 9 percent this year, to $3.0 trillion, or 17.5 percent of GDP—just above their average percentage of the past 40 years (see Figure 2 on page 6). Revenues were well below that average in recent years, both because the income of individuals and corporations fell during the recession and because policymakers reduced some taxes. The expiration of various tax provisions and the improving economy underlie CBO's projection that revenues will rise sharply this year. Those factors will increase revenues further in 2015, with CBO's baseline showing another 9 percent rise. After 2015, revenues are projected to grow at about the same pace as output and to average 18.1 percent of GDP under the current-law assumptions of CBO's baseline.

### Spending

Federal outlays are expected to increase by 2.6 percent this year, to $3.5 trillion, or 20.5 percent of GDP—their average percentage over the past 40 years. CBO projects that under current law, outlays will grow faster than the economy during the next decade and will equal 22.4 percent of GDP in 2024. With no changes in the applicable laws, spending for Social Security, Medicare (including offsetting receipts), Medicaid, the Children's Health Insurance Program, and subsidies for health insurance purchased through exchanges will rise from 9.7 percent of GDP in 2014 to 11.7 percent in 2024, CBO estimates. Net interest payments by the federal government are also projected to grow rapidly, climbing from 1.3 percent of GDP in 2014 to 3.3 percent in 2024, mostly because of the return of interest rates to more typical levels. However, the rest of the government's noninterest spending—for defense, benefit programs other than those mentioned above, and all other nondefense activities—is projected to drop from 9.4 percent of GDP this year to 7.3 percent in 2024 under current law.

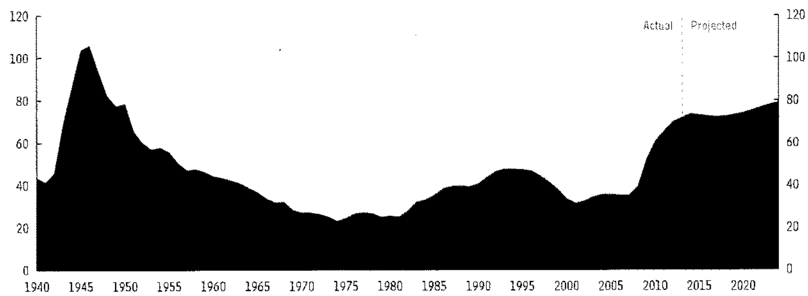
### Changes From CBO's Previous Projections

Since May 2013, when CBO issued its previous baseline budget projections, the agency has reduced its estimate of this year's deficit by $46 billion and raised its estimate

**Figure 1.**

**Federal Debt Held by the Public**

(Percentage of gross domestic product)




Source: Congressional Budget Office.

of the cumulative deficit between 2014 and 2023 by $1.0 trillion. (That 10-year period was the one covered by the previous baseline.) Those changes result from revisions to CBO's economic forecast; newly enacted legislation; and other, so-called technical factors, such as new information about recent spending and tax collections.

Most of the increase in projected deficits results from lower projections for the growth of real GDP and for inflation, which have reduced projected revenues between 2014 and 2023 by $1.4 trillion. Legislation enacted since May has lowered projected deficits during that period by a total of $0.4 trillion (including debt-service costs). Other changes to the economic outlook and technical changes have had little net effect on CBO's deficit projections.

## Economic Growth Is Projected to Be Solid in the Near Term, but Weakness in the Labor Market Will Persist

In the next few years, CBO expects, further growth in housing construction and business investment will raise output and employment, and the resulting increase in income will boost consumer spending. In addition, under current law, the federal government's tax and spending policies will not restrain economic growth to the extent they did in 2013, and state and local governments are likely to increase their purchases of goods and services (adjusted for inflation) after having reduced them for several years. As a result, CBO projects, real GDP will expand more quickly from 2014 to 2017—at an average rate of 3.1 percent a year—than it did in 2013.

By the end of 2017, the gap between GDP and potential GDP (the maximum sustainable output of the economy) is expected to be nearly eliminated (see Figure 3 on page 7). Between 2018 and 2024, GDP will expand at the same rate as potential output—by an average of 2.2 percent a year, CBO projects. Thus, CBO anticipates that over the 2014–2024 period as a whole, real GDP will increase at an average annual pace of 2.5 percent.

### The Economic Outlook Through 2017

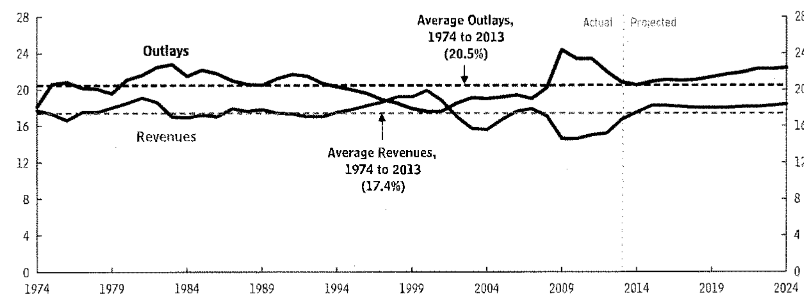
Real GDP is projected to grow by 3.1 percent this year, by 3.4 percent in 2015 and 2016, and by 2.7 percent in 2017 (see Table 2 on page 8).[1] CBO expects that those increases in output will spur businesses to hire more workers, pushing down the unemployment rate and

1. CBO's economic projections are based on information available through early December 2013. Data released since then indicate that the economy grew more rapidly at the end of 2013 than CBO had expected. If CBO were completing new economic projections now, it would probably trim its projection of growth for the next few years but make little change to its projections of the level or growth rate of GDP after that.

**Figure 2.**

## Total Revenues and Outlays

(Percentage of gross domestic product)




Source: Congressional Budget Office.

tending to raise the rate of participation in the labor force (as some discouraged workers return to the labor force in search of jobs). That effect on participation in the labor force will keep the unemployment rate from falling as much as it would otherwise: CBO projects that the unemployment rate will decline only gradually over the next few years, finally dropping below 6.0 percent in 2017. Nevertheless, the labor force participation rate is projected to decline further because, according to CBO's analysis, the upward pressure on that rate from improvements in the economy will be more than offset by downward pressure from demographic trends, especially the aging of the baby-boom generation.

CBO expects that the PCE price index will increase by less than 2.0 percent a year for the next several years. With such low inflation and considerable slack in the labor market, CBO anticipates that the Federal Reserve will keep short-term interest rates (such as those on 3-month Treasury bills) at their current low levels until mid-2015 but that long-term interest rates (such as those on 10-year Treasury notes) will gradually rise as the economy strengthens.

### The Economic Outlook for 2018 to 2024

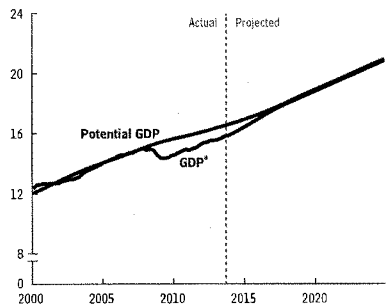
Beginning in 2018, CBO's projections of GDP are based not on forecasts of cyclical movements in the economy but on projections of trends in the factors that underlie potential output, including total hours worked by labor, capital services (the flow of services available for production from the nation's stock of capital goods, such as equipment, buildings, and land), and the productivity of those factors. In CBO's projections, the growth of potential GDP over the next 10 years is much slower than the average since 1950. That difference stems primarily from demographic trends that have significantly reduced the growth of the labor force. In addition, changes in people's economic incentives caused by federal tax and spending policies set in current law are expected to keep hours worked and potential output during the next 10 years lower than they would be otherwise. Although CBO projects that GDP will expand at the same rate as potential GDP, CBO also projects, on the basis of historical experience, that the level of GDP will fall slightly short of its potential, on average, from 2018 through 2024.

The unemployment rate is expected to edge down from 5.8 percent in 2017 to 5.5 percent in 2024 because factors associated with the persistently high long-term unemployment experienced in recent years are expected to have diminishing effects on the unemployment rate after 2017. As measured by the PCE price index, both inflation and core inflation (which excludes the prices of food and energy) are projected to average 2.0 percent a year between 2018 and 2024. Interest rates on 3-month Treasury bills are projected to average 3.7 percent during those years, and rates on 10-year Treasury notes are projected to average 5.0 percent.

**Figure 3.**

## GDP and Potential GDP

(Trillions of 2009 dollars)




Sources: Congressional Budget Office; Bureau of Economic Analysis.

Notes: Potential gross domestic product (GDP) is CBO's estimate of the maximum sustainable output of the economy.

Data are quarterly. Actual data are plotted through the second quarter of calendar year 2013; projections are plotted through the fourth quarter of 2024. Those projections, which are based on information available through early December 2013, do not reflect recently released data that show a higher level of GDP during the second half of 2013 than CBO had expected. If the projections were updated to incorporate those recent data, the gap between GDP and potential GDP would be slightly narrower in the second half of 2013 and in the next few years.

a. From 2018 to 2024, the projection for GDP falls short of that for potential GDP by one-half of one percent of potential GDP.

**Table 2.**

## CBO's Economic Projections for Calendar Years 2014 to 2024

| | Estimated, 2013 | Forecast 2014 | 2015 | 2016 | 2017 | Projected Annual Average, 2018-2024 |
|---|---|---|---|---|---|---|
| | | **Fourth Quarter to Fourth Quarter (Percentage change)** | | | | |
| Real Gross Domestic Product | 2.1 | 3.1 | 3.4 | 3.4 | 2.7 | 2.2 |
| Inflation | | | | | | |
| PCE price index | 0.9 | 1.5 | 1.7 | 1.8 | 1.9 | 2.0 |
| Core PCE price index[a] | 1.1 | 1.6 | 1.8 | 1.9 | 1.9 | 2.0 |
| Consumer price index[b] | 1.2 [c] | 1.9 | 2.1 | 2.1 | 2.3 | 2.4 |
| Core consumer price index[a] | 1.7 [c] | 1.9 | 2.2 | 2.2 | 2.3 | 2.3 |
| | | **Fourth-Quarter Level (Percent)** | | | | |
| Unemployment Rate | 7.0 [c] | 6.7 | 6.3 | 6.0 | 5.8 | 5.5 [d] |
| | | **Calendar Year Average (Percent)** | | | | |
| Interest Rates | | | | | | |
| Three-month Treasury bills | 0.1 [c] | 0.2 | 0.4 | 1.8 | 3.3 | 3.7 |
| Ten-year Treasury notes | 2.4 [c] | 3.1 | 3.7 | 4.3 | 4.8 | 5.0 |

Source: Congressional Budget Office.

Notes: Estimated values for 2013 do not reflect the values for gross domestic product and related series released by the Bureau of Economic Analysis since early December 2013.

PCE = personal consumption expenditures.

a. Excludes prices for food and energy.

b. The consumer price index for all urban consumers.

c. Actual value for 2013. (Actual values come from the Bureau of Labor Statistics and the Federal Reserve.)

d. Value for 2024.

Congressional Budget Office

JUNE 10, 2014

# Answers to Questions for the Record Following a Hearing on the Budget and Economic Outlook for 2014 to 2024 Conducted by the Senate Committee on the Budget

*On February 11, 2014, the Senate Committee on the Budget convened a hearing at which Douglas W. Elmendorf, Director of the Congressional Budget Office, testified about CBO's report* The Budget and Economic Outlook: 2014 to 2024 *(February 2014), www.cbo.gov/publication/45010. Some Members of the Committee submitted further questions for the record, and this document provides CBO's answers.*

**Ranking Member Jeff Sessions**

**Question:** On page 117 of Appendix C of the latest Budget and Economic Outlook, "CBO estimates that the [Affordable Care Act] will cause a reduction of roughly 1 percent in aggregate labor compensation over the 2017–2024 period, compared with what it would have been otherwise." CBO also reports that "the largest declines in labor supply will probably occur among low-wage workers."

Based on CBO's estimates in Appendix C, please provide the data and a distributional analysis showing who would be affected by the reduction in compensation. Please provide the median income of workers that will experience a reduction in labor compensation in each year over the 2014 to 2024 period. Please also provide the number of workers making less than 400 percent of the federal poverty level that will experience a reduction in labor compensation, including the average income for this group and the average reduction in labor compensation for this group.

**Answer:** As described in Appendix C of *The Budget and Economic Outlook: 2014 to 2024* (www.cbo.gov/publication/45010), the Congressional Budget Office expects that the Affordable Care Act (ACA) will reduce the number of full-time-equivalent workers by about 2.0 million in 2017; that number will increase to about 2.5 million in 2024. That reduction will occur almost entirely because workers will choose to supply less labor given the new taxes and other incentives they will face and the financial benefits some will receive. Some of the reduction will arise from people choosing not to work at all and some will arise from other people choosing to work fewer hours than they would have in the absence of the law.

CBO's method for estimating the labor market effects of the ACA was designed to estimate the aggregate effect but not the effect on individual workers or subsets of the population. Consequently, CBO does not have a basis for estimating either the median income of the workers who will experience a reduction in labor compensation or the effects on workers whose income is below 400 percent of the federal poverty guidelines (commonly called the federal poverty level, or FPL).

The subsidies for health insurance purchased through the exchanges and the expansion of eligibility for Medicaid account for the largest effects on labor supply. Because only families whose income is below 400 percent of the FPL are eligible for those programs under the ACA, the largest declines in labor supply will occur among such families. Other provisions of the law will affect people in that income range and in higher income ranges.

**Question:** In November 2012, CBO released a paper (*Effective Marginal Tax Rates for Low- and Moderate-Income Workers*) that complements the analysis found in Appendix C of the latest Budget and Economic Outlook. That paper estimates the effective marginal tax rates for low- and moderate-income workers and finds that increases in earnings for low-wage workers can cause large reductions in federal assistance programs relative to their incomes, which also reduces their incentive to work.

Please provide an estimate of the reduction in aggregate labor compensation and hours worked caused by the other federal low-income assistance programs included in CBO's November 2012 analysis that is in addition to the reduction caused by the Affordable Care Act over the 2014 to 2024 period.

**Answer:** CBO has not estimated the effects of other low-income assistance programs on labor markets, and doing so would be a complex and difficult undertaking. A November 2012 study, *Effective Marginal Tax Rates for Low- and Moderate-Income Workers* (www.cbo.gov/publication/43709), examined the effects of some other transfer programs, such as the Supplemental Nutrition Assistance Program and federal housing assistance, on marginal tax rates (that is, the rates that apply to their last dollar of income) for low- and moderate-income families, but not on labor markets. CBO is working to improve its ability to estimate the effects of federal policy on economic activity, including its ability to estimate the effects of transfer programs on labor supply.

**Question:** CBO has reported that borrowing for economic stimulus programs provides a short-term benefit to the economy, but is a net detriment over 10 years. For example, CBO estimated that the 2009 stimulus legislation would increase economic output near term, but noted that over 10 years output would be lower because of the increase in government debt (February 11, 2009, Letter to Senator Gregg).

Is it therefore correct to say that the benefit of economic stimulus programs financed through increased federal deficits is short-lived, but that their cost is permanent, continuing for decades afterwards because of the added federal debt?

**Answer:** Relative to projections under current law, CBO estimates, policies that led to larger deficits by raising spending or cutting taxes would boost real (inflation-adjusted) gross domestic product (GDP) in the short term—reflecting the effects of tax and spending policies on the demand for goods and services. By contrast, CBO estimates that sustained higher deficits would lead to lower GDP over the longer term—reflecting the effect of deficits on national saving and domestic investment (but not accounting for any changes to households' incentives to work or save stemming from changes to tax policies or benefit programs). CBO's analysis of the economic effects of the American Recovery and Reinvestment Act is an example of those points (see CBO's letter to the Honorable Judd Gregg concerning the estimated macroeconomic impacts of H.R. 1 as passed by the House and by the Senate, February 11, 2009, www.cbo.gov/publication/20474). On the basis of those estimates, CBO concludes that the benefits of fiscal stimulus are temporary but the costs are permanent.

Some researchers have reached a different conclusion, however, maintaining that policies that boost overall demand in the short term under current economic conditions may have positive economic and budgetary effects in the long term as well because the increase in demand raises the economy's long-term potential (maximum sustainable) output by enough to offset the negative effects on potential output of higher federal borrowing. If, for example, a short-term increase in overall demand lowers the natural rate of unemployment (the rate that arises from all sources except fluctuations in aggregate demand) in the longer term, that effect will increase labor income and tax revenues in the longer term as well. How significant such an effect might be is unclear. Moreover, that effect would interact with the negative effects on investment and federal borrowing costs that also result from the increase in federal deficits. Given the uncertainty of the channels through which a short-term increase in demand could raise potential output in the long term, CBO does not incorporate such an effect in its analyses, although the agency continues to investigate this issue.

It is also possible for lawmakers to enact policy changes that vary over time. If lawmakers wanted to raise GDP both in the short term and the longer term relative to projections under current law, they could devise a combination of policies that increased deficits during the first few years and decreased them by a greater cumulative amount thereafter (ultimately leading to less debt than would arise under current law).

**Question:** CBO estimates that the growth of real GDP will decline over the current budget window, reaching only 2 percent in 2024 (4th quarter to 4th quarter). But perhaps more important to the standard of living of working Americans is the growth in per capita GDP.

Staff has estimated that the growth in per capita GDP (with total population in the denominator) declines every year after 2016 in CBO's outlook. Please provide CBO's estimates of real GDP per capita for each year of the budget window and the rate of change of that indicator. Please also provide analysis regarding the implications of declining per capita output for Americans' standard of living, including data on the likely effect on wages by income.

**Answer:**

**CBO's Projections of Real GDP Per Capita, 2014 to 2024**
(Thousands of 2009 dollars)

| | GDP Per Capita | Percentage Change From Prior Year |
|---|---|---|
| 2014 | 50.9 | 1.9 |
| 2015 | 52.0 | 2.2 |
| 2016 | 53.2 | 2.2 |
| 2017 | 54.0 | 1.6 |
| 2018 | 54.8 | 1.4 |
| 2019 | 55.5 | 1.3 |
| 2020 | 56.1 | 1.2 |
| 2021 | 56.8 | 1.2 |
| 2022 | 57.5 | 1.2 |
| 2023 | 58.2 | 1.2 |
| 2024 | 58.8 | 1.1 |

Note: Projections are for the fourth quarter of each calendar year.

Real GDP = gross domestic product adjusted to remove the effects of inflation.

Many factors, including per capita GDP, affect Americans' standard of living. Although CBO has not analyzed all of those factors or their effects, the agency projects that real GDP per capita will grow, on average, by about 2 percent per year between 2014 and 2017, when it is expected to return to its historical relationship with the economy's potenrial output. CBO projects that, after 2017, real GDP will grow at the same rate as potential GDP—by an average of about 2¼ percent per year during the 2018–2024 period—because the agency does not attempt to predict the timing or magnitude of business cycle fluctuations in the economy so far into the future. With the population expected to grow by about 1 percent per year, real GDP per capita is projected to grow, on average, by about 1¼ percent per year between 2018 and 2024—a slower rate than the annual average rate of about 2 percent since 1950. That difference reflects CBO's projection that real GDP will grow more slowly over the latter part of the projection period than it has in the past several decades, primarily because of slower growth of the labor force stemming from the retirement of the baby boom generation.

CBO has not analyzed the effects of changes in per capita GDP on wages by income quartile. However, the projected slower-than-average growth in GDP would be expected to lead to slower-than-average growth in wages, salaries, and overall income across the economy.

**Senator Mike Crapo**

**Question:** Do you believe the fiscal crisis is over? Do you believe that Washington's balance sheet is now on sustainable footing?

**Answer:** The Congressional Budget Office projects that the economy will grow notably faster over the next few years than it has in the recent past. Real gross domestic product (or GDP; real GDP is output adjusted to remove the effects of inflation) is expected to increase by roughly 3 percent between the fourth quarter of 2013 and the fourth quarter of 2014—the largest rise in nearly a decade. Similar annual growth rates are projected through 2017. Nevertheless, CBO estimates that the economy will continue to have considerable unused labor and capital resources (or "slack") for the next few years. Although the unemployment rate is expected to decline, CBO projects that it will remain above 6.0 percent until late 2016.

Although the federal budget deficit has fallen sharply during the past few years and is on a path to decline further this year and next, the nation's long-term budgetary outlook remains worrisome. The large budget deficits recorded in recent years have substantially increased federal debt, and the amount of debt relative to the size of the economy is now very high by historical standards. Assuming that no legislative action is taken that would significantly affect revenues or spending, CBO estimates that federal debt held by the public will equal 74 percent of GDP at the end of this year and will reach 79 percent in 2024, its highest level since 1948 and roughly double the average of about 40 percent experienced over the 1974–2013 period. Under current law, it is projected to grow steadily after that. Under CBO's extended baseline, federal debt held by the public is projected to reach 95 percent of GDP by 2030 and 135 percent by 2040 and would, at that point, be on an upward path (see *Budgetary and Economic Outcomes Under Paths for Federal Revenues and Noninterest Spending Specified by Chairman Ryan, April 2014,* www.cbo.gov/publication/45211).

Increased borrowing by the government eventually would reduce private investment in productive capital because the portion of total savings that investots used to buy Treasury securities would not be available to finance private investment. The result would be a smaller stock of capital and lower output and income in the long term than would otherwise be the case. Lower income would reduce tax revenues, but it also would reduce federal spending—although by a smaller amount—for example, by decreasing benefits from Social Security.

The large and growing amount of federal debt that CBO projects under the extended baseline would have significant negative consequences in addition to its effects on output and the economic feedback on the budget. Higher federal spending to pay interest on the debt would require larger changes in tax and spending policies to meet any chosen targets for budget deficits and debt. At the same time, the government would have less flexibility to use tax and spending policies to respond to unexpected challenges, such as those posed by an economic downturn or a war. In addition, the risk of a fiscal crisis—in which investors would demand very high interest rates to finance the government's borrowing needs—would be greater.

**Question:** Your report projects the economy to hit its potential in 2017, and grow at 2.7 percent, correct? But then you have lowered your projections for the remainder of the budget window, with growth only averaging 2.2 percent. What is the cause of the lowering of your projections of economic growth?

**Answer:** Economic growth in the early years of the projection period is projected to be faster, on average, than in the later years because in the early years, the economy will still be in the process of recovering from the recent recession. As measured by the change from the fourth quarter of the previous year, real GDP is projected to increase by 3.1 percent in 2014 and by 3.4 percent per year in 2015 and 2016; real GDP is projected to grow by 2.7 percent in 2017, when it is expected to return to its historical relationship with potential (or maximum sustainable) GDP. Thereafter, from 2018 through 2024, CBO projects that real GDP will grow at the same rate as potential output; the agency does not attempt to predict the timing or magnitude of business cycle fluctuations in the economy so far into the future. Real GDP is projected to grow, on average, by 2.2 percent annually over that period.

Potential GDP is projected to grow by 2.1 percent per year, on average, over the next decade—significantly below the average rate since 1950. That difference is attributable mostly to long-term trends—notably, the slower growth of the labor force that will result from the aging of the baby-boom generation. In addition, by CBO's estimates, potential GDP in 2024 will be constrained by the lingering effects of the recent recession and the ensuing slow recovery and by federal tax and spending policies in current law.

**Question:** Your report projects a dramatic decline in the labor force participation rate, with the rate in 2024 being only 60.8 percent, the lowest rate since 1973. What are the drivers of this exodus from the workforce?

**Answer:** CBO projects that the labor force participation rate, which averaged 62.9 percent in the fourth quarter of 2013, will stay the same, on average, in 2014 but will decline to 62.5 percent by the end of 2017 and to 60.8 percent by the end of 2024. (In the fourth quarter of 2007, when the last recession began, the labor force participation rate was 66.0 percent.)

From now through 2017, CBO anticipates, many people who left the labor force because of a lack of job opportunities will return as labor market conditions improve, and the number of people who stay out of the labor force altogether (for example, to attend school) will diminish. However, CBO expects, the cyclical recovery in participation will be more than offset by the downward pressure on participation that arises from structural changes in the labor market that have boosted the natural rate of unemployment (the rate of unemployment that arises from all sources except fluctuations in aggregate demand). The most significant effect will come from the aging of the population. To a lesser extent, the Affordable Care Act (ACA) also will tend to reduce participation during those years, although its full impact will not be felt until later in the coming decade. Several provisions of the ACA will affect the labot market, but the largest effects on labor force participation will arise from new subsidies that reduce the cost of health insurance purchased through exchanges. Because the ACA provides larger subsidies to people with lower income, their net compensation for an additional hour of work will be reduced; in addition, those subsidies will make some of them better off financially. As a result, some will choose to work less than they otherwise would.

The further projected decline in the participation rate after 2017 primarily reflects demographic changes, especially the ongoing aging of the population. Those effects are offset in part by a reduction in the number of people who will have permanently stopped looking for work because of the recession and the ensuing slow recovery; many of those people would, by that period, have left the labor force anyway through retirement or by some other means. Still, CBO estimates that the lasting effects of the recession and slow recovery will depress labor force participation by 0.4 percentage points in 2024.

**Question:** Is it not true that, if allowed to continue on their current course, the Social Security Disability Insurance program will be insolvent within the next two to three years? Is it also not true that the Medicare program is projected to be insolvent just beyond the 2024 ending of the current budget window, and that Social Security is projected to be insolvent within 10 years of the end of the budget window?

**Answer:** As indicated in *The Budget and Economic Outlook: 2014 to 2024* (www.cbo.gov/publication/45010), CBO expects that, unless some legislative action is taken, the balance of Social Security's Disability Insurance Trust Fund will be exhausted in fiscal year 2017. Under its extended baseline, CBO projects that the trust fund that finances Social Security's Old-Age and Survivors Insurance will be exhausted in calendar year 2033 and that, if considered together, Social Security's trust funds will be exhausted in calendar year 2031. Those latter projections were published last September in *The 2013 Long-Term Budget Outlook* (page 54, www.cbo.gov/publication/44521).

CBO projects that, under current law, Medicare's Hospital Insurance Trust Fund (which accounts for payments made to hospitals and providers of postacute care services under Medicare's Part A) is likely to be exhausted just after 2024. Other parts of Medicare also have trust funds, but they are financed in part by transfers from the U.S. Treasury's general fund in a way that generally will prevent them from becoming exhausted.

**Question:** Your report indicates revised anticipated exchange enrollment numbers down from 7 million to 6 million in 2014 due to technical difficulties during the website rollout. Does this number also consider individuals who did not enroll in exchange plans because they were allowed to keep noncompliant health plans through 2014?

Given the Obama Administration's recent announcement that it may extend the ability to keep noncompliant plans for an additional 3 years, what effect do you think this will have on future enrollment?

More importantly, what will continued low enrollment do to future premiums for plans purchased on the exchange?

**Answer:** In April, CBO released *Updated Estimates of the Effects of the Insurance Coverage Provisions of the Affordable Care Act* (www.cbo.gov/publication/45231), which indicates that, over the course of calendar year 2014, an estimated 6 million people will be covered by insurance obtained through the exchanges. The total number who will have coverage at some points during the year is expected to be more than the average because some people will be covered for only part of the year. The projection takes into account the Administration's March 2014 announcement that, through October 1, 2016, state insurance commissioners may permit health insurers to re-enroll individuals and small businesses in existing plans that do not comply with the ACA's rules, allowing such coverage to continue through September 2017. That announcement extended an action announced in November 2013 that permitted the renewal of noncompliant policies through October 1, 2014 (extending coverage through September 2015).

CBO and the staff of the Joint Committee on Taxation (JCT) estimate that the March 2014 announcement will slightly reduce enrollment in ACA-compliant plans sold through the exchanges and through the nongroup and small-group markets outside of the exchanges because some people will take advantage of this option by renewing their coverage in noncompliant plans. CBO and JCT also estimate that the March announcement will slightly reduce federal spending for exchange subsidies because some people who would have enrolled in a subsidized plan through the exchanges will instead renew coverage in noncompliant plans (which cannot be sold through the exchanges and are not subsidized). In addition, the lower premiums that small employers and self-employed people are likely to pay for noncompliant plans will generate a small amount of additional tax revenues because those enrollees will have more taxable income as a result.

CBO and JCT expect that people who renew noncompliant plans will be healthier, on average, than people who enroll in ACA-compliant plans, leading to slightly higher medical claims per enrollee in ACA-compliant plans. However, CBO and JCT expect that such adjustments will have a negligible effect on average premiums in exchange plans because the number of people who re-enroll in noncompliant plans will probably be small relative to total enrollment in exchange plans. CBO and JCT expect that enrollment in noncompliant plans in the nongroup market outside of the exchanges will total about 2 million in 2014. As the effects of early renewals and the administrative extensions wane, such enrollment is projected to decline to 1 million in 2015 and then to fall to negligible numbers of people in 2016 and thereafter.

CBO and JCT have not analyzed what would happen to premiums if enrollment in exchange plans remained relatively low. In its April 2014 report, CBO projects that enrollment in exchange plans will increase from 6 million in 2014 to 25 million in 2017 and later years. The report identified two competing ways in which rising enrollment will affect premiums—forces that might not arise if enrollment does not grow:

- On the one hand, CBO and JCT anticipate that exchange enrollees in the future will be healthier, on average, than the smaller number of people who are obtaining such coverage in 2014. That factor is expected to lower premiums in 2015 relative to those in 2014.

- On the other hand, CBO and JCT anticipate that as enrollment increases, many exchange plans will not be able to sustain provider payment rates that are as low or provider networks that are as narrow as they appear to be in 2014. That factor will raise exchange premiums in 2015 relative to those in 2014.

Whether premiums will be higher or lower than currently projected if enrollment in exchange plans turns out to be lower than CBO anticipates will thus not be clear without careful additional analysis.

**Question:** Although the employer mandate has not yet taken effect, can you anticipate what percentage of the 2.5 million full-time equivalent positions will be lost due to employers limiting employee hours in order to avoid paying penalties for not providing insurance?

**Answer:** As indicated in Appendix C of *The Budget and Economic Outlook: 2014 to 2024* (www.cbo.gov/publication/45010), CBO estimates that the ACA will reduce the total number of hours worked, on net, by about 1.5 percent to 2.0 percent from 2017 to 2024, almost entirely because workers will choose to supply less labor. The reason for the reduction in the supply of labor is that, for certain subsets of the population, the provisions of the ACA reduce the incentive to work.

For example, under the ACA, health insurance subsidies are provided to some people with low income and are phased out as their income rises; as a result, a portion of the added income from working more would be offset by a loss of some or all of the subsidies, which represents an implicit tax on earnings. Also, the ACA's subsidies effectively boost the income of recipients, leading some of them to decide that they can work less and still maintain or improve their standard of living. Therefore, some people will decide either not to work at all or to work fewer hours than they would otherwise, including some who will choose to retire earlier than they would otherwise and some who will work less themselves and instead rely more on a spouse's earnings. (Among the many other factors that influence decisions about working are income and payroll taxes and the cost of commuting and child care. Moreover, under current economic conditions, a substantial number of people who would like to work cannot find employment.)

CBO did not estimate a reduction in overall employment stemming from employers' limiting workers' hours to avoid paying penalties under the ACA. (CBO estimates that the employer penalty will reduce employment for other reasons, as discussed in Appendix C.) Over time, CBO expects, the penalty will be borne primarily by workers in the form of reduced wages or other compensation, at which point the penalty will have little effect on the demand for labor.

Nevertheless, some businesses may respond to the penalty by seeking to reduce or limit full-time staffing, to hire more part-time employees, or both. Those responses might occur because the penalty will apply only to businesses with 50 or more full-time-equivalent employees, and employers will be charged only for each full-time employee (not counting the firsr 30). People are generally considered full time under the ACA if they work 30 hours or more per week, on average, so employers have an incentive, for example, to shift from hiring a single 40-hour, full-time employee to hiring two, 20-hour part-time employees to avoid paying the penalty.

Such a change might or might not, on its own, reduce the total number of hours worked. For instance, a business that reduces hours for some workers might employ more people overall in order to maintain the total number of hours worked and total output—as in the example just offered. Moreover, adjustments of that sort can be costly for employers—because of the time and expense involved in dismissing full-time workers (which can result in the loss of workers with valuable job-specific skills); hiring new part-time workers (including the effort spent on interviewing and training); and, perhaps most important, changing work processes to accommodate a larger number of employees working shorter and more varied schedules. The extent to which people would be willing to work at more than one part-time job instead of a single full-time job also is unclear; although hourly wages for people in full-time jobs might be lower than those for part-time workers (once wages are adjusted to reflect the penalty), part-time workers would incur additional costs associated with holding more than one job at a time.

In CBO's judgment, there is no compelling evidence that the ACA has resulted in an increase in part-time employment. However, the agency will continue to monitor the situation, recognizing that the limited evidence currently available about shifts to part-time employment may not be very informative about the ultimate effects of the ACA because enforcement of the employer penalty has been delayed.

**Question:** Since your report was released [in February 2014], there has been much discussion about your findings that Obamacare would reduce full-time equivalent employment by about 2.3 million in 2021. But there has nor been much discussion about the consequences to the budget of that loss in workforce. Such a dramatic reduction in the workforce would mean that there would be fewer Americans working and earning taxable income. As such, would you not expect a resulting decrease in both income and payroll tax revenue being collected by the government? If so, does your report incorporate those reductions in income and payroll tax revenue?

**Answer:** Yes, reductions in the amount of labor income earned in the economy will lead to reduced income and payroll tax revenues. CBO's baseline economic and revenue projections incorporate the agency's estimates of the effects of federal policy on economic activity and tax revenues. Hence, those projections account for the ACA, including its effects on labor markets. However, CBO has not attempted to isolare the revenue effect of the labor market changes attributable to the act from other factors that affect economic activity or tax revenues overall.

**Question:** A significant reduction in payroll tax revenue would also affect the solvency of the entitlement programs supported by that payroll tax revenue, correct? Does your report include projections on how the decline in full-time equivalent employment as a result of the Affordable Care Act would affect the solvency of Medicare and Social Security?

**Answer:** Yes, a reduction in payroll tax revenue will adversely affecr the trust funds for Medicare and Social Security. Those effects are included in the projections discussed in Appendix F of *The Budget and Economic Outlook: 2014 to 2024* (www.cbo.gov/publication/45010).

CBO did not estimate separately how the decline in employment resulting from the ACA will affect the trust funds' exhaustion dates, but such an analysis would have ro take into account several competing considerations. For example, one channel CBO identified for the decline in labor supply undet the ACA is that people will retire earlier than they would in the absence of the ACA. If the people who retire sooner also start receiving Social Security benefits sooner, the program's spending would tise in the near term. But Social Security spending over their lifetime might not increase because monthly benefits are lower for people who choose to start receiving benefits earlier. More generally, declines in hours worked will reduce payroll tax revenues but also will tend to reduce the amount of Social Security benefits for which people qualify when they enroll in the program (those benefits are calculated on the basis of a recipient's earnings history), so the net effect on exhaustion dates is not immediately clear.

The decline in payroll tax revenues also will have an adverse effect on the exhaustion date of Medicare's Hospital Insurance Trust Fund, holding all else equal. However, the reduction in employment—compared with what would have occurred in the absence of the ACA—will reduce total gross domestic product, and somewhat fewer goods and services will be produced. If some of that reduction in employment and output comes in the health sector, it could reflect a reduction in the use of health care services and thus a reduction in spending on Medicare and other federal programs.

**Question:** Your testimony also suggested that the reduction in full-time equivalent employment would be felt most by lower-income households, as the incentives to leave the workforce would be greater for them. Would another consequence of taking more lower-income Americans out of the income earning and income tax paying workforce be to further narrow the income tax base of our country, and thus result in an even more progressive tax code, as the burden of supporting both discretionary and mandatory programs would continue to be concentrated on fewer households.

**Answer:** CBO estimates that the ACA will reduce aggregate labor compensation by roughly 1 percent over the 2017–2024 period, almost entirely because workers will choose to supply less labor. That decline will consist of some people not being employed and other people working fewer hours. The largest declines in labor supply will probably occur in households with below-average earnings because those households are most likely to be affected by the availability of subsidies for health insurance purchased through exchanges and by the expansion of eligibility for Medicaid.

In general, people who work less also pay less in taxes. Thus, the change in employment will probably decrease the share of taxes paid by lower-income households—one measure of the progressivity of the tax system. Under progressivity measures that compare shares of taxes paid with shares of before-tax income, the effect is more ambiguous, because taxes and before-tax income alike will decline for lower-wage households.

### Senator Michael Enzi

**Question:** CBO estimates a 9 percent revenue increase for this year and projects the economy will also grow at a solid pace. I want to ensure that we all don't leave this hearing thinking that there is a direct line between increased revenues through tax hikes and increased economic growth. In that regard, to what extent do increased taxes that pull money out of the hands of both employers and employees have a negative impact on your economic growth projections?

**Answer:** In general, the Congressional Budget Office expects that higher tax payments have different short- and long-term effects. In the short term, they tend to reduce demand for goods and services and thereby to dampen economic activity. In contrast, economic growth in the longer-term is driven by supply factors, so longer-run effects of higher tax payments depend mainly on the influence of tax policy on the supply of labor and capital. Those effects could boost or diminish economic growth, depending on the specifics of tax policy. All else being equal, higher tax revenues decrease budget deficits and, thereby, government borrowing, thus boosting investment. Higher tax rates, however, decrease people's saving and work effort.

(For example, CBO estimates a dampening in the labor supply over time stemming from increases in effective marginal tax rates on labor income—the rates that apply to the last dollar of income—that are anticipated to arise from real bracket creep and from some provisions of the Affordable Care Act, or ACA). The net effect of higher taxes on economic activity depends on the balance of those forces.

**Question:** CBO's report should worry everyone in the room because it projects that the national debt will be $1.4 trillion higher in 2023 than CBO estimated last year, totaling 79 percent of GDP in 2024. Would taking action sooner rather than later to reduce our $17 trillion—and growing—debt impose less pain, both financially and economically, on the nation and taxpayers? For example, if we were to enact legislation like the Penny Plan (S. 547) that cuts spending by one percent across the board each year for several years to achieve a balanced budget, could the long-term benefits of such a plan—in terms of economic growth and fiscal sustainability—outweigh any potential short-term consequences?

**Answer:** Lawmakers face a difficult trade-off in deciding how quickly to carry out policy changes to reduce the growth of the federal debt. On the one hand, waiting to cut federal spending or raise taxes would lead to a greater accumulation of debt and would increase the size of the policy adjustments needed to put the budget on a sustainable course. That greater debt, together with the effects of the future policy adjustments, could lead to lower output and incomes and the provision of fewer government services in the long run, depending on the specific policy adjustments. On the other hand, implementing substantial spending cuts or tax increases soon would weaken the economy's current expansion and give people little time to plan for and adjust to those policy changes. The negative short-term effects that deficit reduction has on output and employment would be especially acute now because the Federal Reserve could not lower short-term interest rates from their current values, which are near zero, to offset the impact of changes in spending and tax policies. Even if policy changes were not implemented for a few years, however, making decisions about them soon would give people more time to plan and would tend to increase output and employment in the next few years by holding down longer-term interest rates, reducing uncertainty, and enhancing businesses' and consumers' confidence.

**Question.** When we talk about the debt, it's important to discuss the biggest drivers. CBO projects that spending on Medicaid is expected to double in about a decade, from $265 billion in fiscal year 2013 to $574 billion in fiscal year 2024. Medicare spending will not quite double in the same time, increasing from $585 billion in fiscal year 2013 to 1.087 trillion in fiscal year 2024. Social Security spending will increase from $808 billion to $1.506 trillion. Obamacare subsidies and related spending will increase from $1 billion to $166 billion. By 2024, CBO estimates that these programs will consume *half* of the federal budget.

How can we best address this unsustainable trajectory? What steps should Congress take now to address the spending curve for these programs?

**Answer:** To put the federal budget on a sustainable long-term path, lawmakers would need to make significant policy changes—allowing revenues to rise more than would occur under current law, reducing spending for large benefit programs to amounts below those currently projected, or adopting some combination of those methods. Changes in spending for other activities of the federal government could affect the magnitude of the changes needed in taxes or large benefit programs, but they would not eliminate the need for significant changes in at least one of those two parts of the budget. An approach that relied primarily on reductions in federal benefits would almost certainly require substantial cutbacks in spending for the major health care programs, Social Security, or both.

To assist the Congress in examining rhose complex policy issues, in December 2013 CBO published *Choices for Deficit Reduction: An Update* (www.cbo.gov/publication/44967), which presented a broad overview of the kinds of the changes policymakers could consider. Periodically, CBO also releases detailed compilations of policy options for the federal budget. The most recent in that series, *Options for Reducing the Deficit: 2014 to 2023* (November 2013, www.cbo.gov/budget-options/2013/44687), presents 103 options—they are not policy recommendations—that the government could pursue to reduce spending or increase federal revenues over the next decade. Among the options are 17 (in Chapters 2 and 5) that concern Social Security and the major health care programs. CBO estimated that the reductions in outlays from adopting those options would range from $11 billion to $606 billion over a 10-year period.

**Question:** CBO also decreased the number of people it estimates will get health insurance coverage as a result of Obamacare by 1 million people. What were the reasons for this decrease?

**Answer:** In April 2014, CBO and the staff of the Joint Committee on Taxation estimated that, relative to their May 2013 projections, about 1 million fewer people will obtain coverage through the insurance exchanges in 2014, about 2 million fewer people will enroll in Medicaid and the Children's Health Insurance Program in that year as a result of the ACA, and about 2 million fewer people will gain insurance coverage as a result of the ACA than they had estimated earlier (see *Updated Estimates of the Effects of the Insurance Coverage Provisions of the Affordable Care Act*, www.cbo.gov/publication/45231). Those changes in the estimates for 2014 primarily reflect the significant technical problems that were encountered in the initial phases of the ACA's implementation. However, the estimated effect of the ACA on the number of people without health insurance in future yeats was substantially similar in the April 2014 projections and the May 2013 projections. CBO also provided information about enrollment projections and changes to those projections over time in Appendix B of *The Budget and Economic Outlook: 2014 to 2024* (www.cbo.gov/publication/45010).

**Question:** On the other hand, CBO now projects that more than 2 million people will stop looking for work or remove themselves from the labor supply because of the incentives in the health care law. Tbis is an increase from CBO's previous estimate of 800,000. Why has this number increased?

**Answer:** As indicated in Appendix C of *The Budget and Economic Outlook: 2014 to 2024*, there are two significant reasons that CBO's estimates of the ACA's effects on hours worked and full-time-equivalent employment were considerably higher than the agency's previous estimates of those effects in 2010.

First, several factots led CBO to boost its estimate of the ACA's effect on aggregate labor compensation in the economy from a reduction of about 0.5 percent to a reduction of about 1 percent, the most important of which are these:

- More detailed analysis of the ACA led CBO to incorporate additional channels through which the law will affect labor supply. In particular, CBO's 2010 estimate did not include the effect on labor supply of the employer penalty or the resulting reduction in wages (as the cost of that penalty is passed on to workers), and it did not include the effect of encouraging part-year workers to delay returning to work in order to retain their insurance subsidies.

- Several studies published since 2010 concerning the labor market effects of the law or of similar policy initiatives—in particular, studies of past expansions or contractions in Medicaid eligibility for childless adults—have pointed to a larger effect on labor supply than CBO had estimated previously.

- A broad review of the tax literature has led to an upward revision in CBO's estimates of the impact of changes in after-tax wages on labor supply.

Second, CBO has increased its estimate of the effect on hours worked that could arise from a given reduction in aggregate compensation under the ACA. The earlier estimate reflected a simplifying assumption that affected workers would have average earnings—and so the percentage reductions in compensation and hours worked would be roughly the same. However, the people whose employment or hours worked will be most affected are expected to have below-average earnings. The effects of the exchange subsidies and of expanded Medicaid eligibility on the amount of labor supplied by lower-income people are likely to be greater than the effects of increased taxes on the amount of labor supplied by higher-income people. According to CBO's more detailed analysis, the 1 percent reduction in aggregate compensation that will occur as a result of the ACA corresponds to a reduction of about 1.5 percent to 2.0 percent in hours worked. Those figures translate to a reduction in full-time-equivalent employment of about 2.0 million in 2017, rising to about 2.5 million in 2024, compared with what would have occurred in the absence of the ACA.

**Question:** CBO also believes that this loss of labor will continue past 2024. How will the unemployment rate decrease if so many people stop looking for work due to the health care law?

**Answer:** The unemployment rate does not include people who have stopped looking for work; rather, it measures the number of people who are not employed but are actively looking for work as a percentage of the labor force (which consists of employed people and people who are not employed but are actively looking for work). The unemployment rate thus can decrease *because* some people stop looking for work and withdraw from the labor force. More generally, the unemployment rate in the longer term will be determined almost entirely by natural frictions in the economy that arise as employers expand and contract their workforces and as workers sort themselves into jobs. (For additional discussion of the factors that will affect the unemployment rate over the next decade, see CBO's report, *The Slow Recovery of the Labor Market*, February 2014, www.cbo.gov/publication/45011.)

**Question:** What are the long-term effects on the economy of entitlement programs that reduce the incentives for people to look for work?

**Answer:** The long-term effects on the economy of any particular program depend on the program's design and financing. However, there are some inherent trade-offs in designing programs that provide benefits to people with low incomes, because the provision of those benefits generally reduces the incentive to earn additional income. For example, subsidies that help lower-income people purchase an expensive product like health insurance must be relatively large in order to encourage a significant proportion of eligible people to enroll. Phasing out those subsidies with rising income so as to limit their total costs effectively raises people's marginal tax rates (the rates that apply to their last dollar of income), thus discouraging work. All else being equal, programs that discourage the supply of labor also lead to lower economic output because fewer hours worked implies less total production.

At the same time, programs that discourage the supply of labor by raising effective marginal tax rates can raise output through other channels. For example, programs that insulate households from unexpected changes in income may encourage workers to be more entrepreneurial and innovative, leading to advancements in technology and business processes that increase economic output. In addition, programs that improve people's health or enhance their education might increase those people's productivity in the labor force.

**Question:** CBO projects that interest [costs] will climb over the next decade—from $233 billion in fiscal year 2013 to $880 billion in fiscal year 2024, which is an increase of 278 percent. At that point, we'll be spending more on interest than we spend on Medicaid, defense, or nondefense discretionary spending. How confident are you in CBO's interest rate projections? What happens if interest rates are higher than projected?

**Answer:** Future interest rate movements are inherently uncertain and many developments could cause rates to diverge from CBO's projections, which are intended to represent the midpoint of a distribution of possible outcomes. Thus, in CBO's judgment, interest rates are as likely to be lower than those the agency projects as they are likely to be higher. Moreover, CBO's projections are broadly consistent with the historical relationships among interest rates, inflation, federal borrowing, the gap between actual and potential (maximum sustainable) gross domestic product (GDP), and the factors that underlie the growth of potential GDP.

The effects of higher interest rates on the federal budget would depend on whether the increase was caused by higher real interest rates (that is, rates adjusted to exclude the effects of inflation) or by higher inflation. CBO estimates that if real interest rates were 1 percentage point higher than expected, the cumulative deficit from 2015 to 2024 would be $1.5 trillion more than it currently projects. However, if inflation was 1 percentage point higher than expected, the cumulative deficit in that period would be $0.8 trillion higher than currently forecast; that effect would include significant but partially offsetting changes in tax revenues and spending for federal programs as well as changes in interest payments. Those estimates do not account for the effects on the federal budget of other differences in economic conditions that would probably accompany higher real interest rates or higher inflation.

### Senator Ron Johnson

**Question.** On March 14, 2013, the Senate Budget Committee voted to approve inclusion of section 501 of the budget resolution, S. Con. Res. 8, ultimately passed by the Senate as a whole:

> When the Congressional Budget Office releases its annual Update to the Budget and Economic Outlook, the Congressional Budget Office shall report changes in direct spending and revenue associated with the Patient Protection and Affordable Care Act (Public Law 111-48) and the Health Care and Education Reconciliation Act of 2010 (Public Law 111-152), including the net impact on the deficit, both with on-budget and off-budget effects. The information shall be similar to that provided in Table 2 of the Congressional Budget Office's March 20, 2010, estimate of the budgetary effects of the Health Care and Education Reconciliation Act of 2010 and the Patient Protection and Affordable Care Act (PPACA), as passed by the Senate.

As this provision was supported by the majority of Senators in passage of the budget resolution, please provide an update on the work that your office has done to provide the requested information, rather than the more limited analysis of coverage-only provisions of the health care law. It is important to account for all spending attributable to the health care law.

**Answer:** In March 2010, just before the Affordable Care Act (ACA) was enacted, the Congressional Budget Office and the staff of the Joint Committee on Taxation (JCT) estimated that changes in direct spending and revenues under the legislation would reduce federal budget deficits by $124 billion over the 2010–2019 period and by roughly one-half of 1 percent of gross domestic product (GDP) over the ensuing decade (see the cost estimate for H.R. 4872, Reconciliation Act of 2010 [Final Health Care Legislation], March 20, 2010, www.cbo.gov/publication/21351).[1] In the four years since those estimates were produced, there have been significant changes in the economic outlook, in the health care and health care financing systems, in CBO and JCT's estimating methodologies, in provisions of law that relate to the ACA, and in the implementation of the ACA as guided by judicial decisions and administrative actions. All of those changes could affect the impact of the ACA on budget deficits, potentially in significant ways.

In response to the request for an estimate of the net impact on the deficit of the ACA, the following points are important:

- Based on revisions to the estimated budgetary effects of aspects of the ACA that CBO and JCT have analyzed, the agencies have no reason to think that their initial assessment that the ACA would reduce budget deficits was incorrect.

- However, the incremental budgetary effects of many provisions of the ACA are embedded in CBO's baseline projections for preexisting programs and tax revenues, and they cannot be separately identified using the agencies' normal estimating procedures—which are generally based on data that reflect all of the provisions of current law, including the ACA.[2]

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1. The letter that reported that cost estimate showed projections of the effects of enacting both the Patient Protection and Affordable Care Act (PPACA) as passed by the Senate (H.R. 3590) and the Health Care and Education Reconciliation Act of 2010 (H.R. 4872). The latter legislation included provisions related to education. CBO uses the term Affordable Care Act to refer to PPACA (Public Law 111-148); the health care provisions of the Reconciliation Act (P.L. 111-152); and the effects of subsequent judicial decisions, statutory changes, and administrative actions. CBO also estimated that the Internal Revenue Service and the Department of Health and Human Services would incur costs of between $5 billion and $10 billion each over 10 years to carry out their responsibilities for implementing the legislation; those costs would be funded through discretionary appropriations.

   For JCT's estimates of the effects of most of the tax provisions in the ACA, see Joint Committee on Taxation, *Estimated Revenue Effects of the Amendment in the Nature of a Substitute to H.R. 4872, the "Reconciliation Act of 2010," in Combination with the Revenue Effects of H.R. 3590, the "Patient Protection and Affordable Care Act ('PPACA')," as Passed by the Senate, and Scheduled for Consideration by the House Committee on Rules on March 20, 2010,* JCX-17-10 (March 20, 2010), http://go.usa.gov/8tNQ.

2. CBO made this point shortly after the enactment of the ACA when the agency first incorporated that legislation into its baseline projections. See *The Budget and Economic Outlook: An Update,* August 2010, Box 1-1, p. 6, www.cbo.gov/publication/21670. See also *Updated Estimates of the Effects of the Insurance Coverage Provisions of the Affordable Care Act,* April 2014, footnote 3, p. 1, www.cbo.gov/publication/45231.

- A retrospective analysis of the effects of a current law is very different from a cost estimate for proposed legislation, particularly because it requires formularion of a counterfactual benchmark representing what would have happened if the law had not been enacted—a challenging undertaking that is beyond the scope of CBO's usual analyses.

- Therefore, CBO and JCT cannot readily provide a retrospective analysis of the ACA that is analogous to the cost estimate provided by the agencies in 2010. That problem is not unique to the ACA but is common to most legislation that affects preexisting federal programs.

Consistent with their statutory responsibilities, CBO and JCT can continue to estimate the effects of prospective legislative actions, such as proposals to modify provisions of the ACA or to repeal the law entirely. Because of the complexities involved in implementing a repeal of the ACA, the budgetary effects of repealing the act at this time would not simply be the opposite of the budgetary effects of the ACA itself.

*Identifying the Budgetary Effects of the Affordable Care Act.* The principal obstacle to producing a new estimate for the ACA is that CBO's cost estimates represent the budgetary effects of legislation relative to the current-law baseline. Because the ACA is part of current law, its budgetary effects would now need to be estimated relative to a counterfactual benchmark that excluded the ACA. CBO does not construct such a counterfactual benchmark for all of the ACA, and attempting to do so would raise significant challenges.

Under CBO and JCT's normal procedures, the agencies still produce separate estimates of the effects of *the ACA's provisions related to insurance coverage,* in part because those provisions established entirely new programs or components of programs and in part because those provisions are mostly being implemented in 2014 or later. In particular, the subsidies to be provided through insurance exchanges and the costs of expanded Medicaid eligibility are not part of the flow of budget data for preexisting programs. Hence, their budgetary consequences can be isolated and reassessed, and the counterfactual—what would have happened to those components of the budget in the absence of the ACA—is clear: Those amounts would have been zero. CBO and JCT have published updated estimates of the effects of those provisions numerous times since 2010 (see *Updated Estimates of the Effects of the Insurance Coverage Provisions of the Affordable Care Act, April 2014,* www.cbo.gov/publication/45231). Over time, the effects of the coverage provisions that are not separately identified in flows of budgetary data will become increasingly difficult to isolate.

By contrast, *the ACA's provisions that are not related to insurance coverage* largely modified existing federal programs and made changes to the existing tax code, so CBO and JCT cannot identify the incremental effects of many of those provisions. Consider the ACA's substantial changes to the Medicare program, many of which have taken effect during the past four years. CBO does not produce baseline projections for Medicare that are based on the program's statutes as of February 2010 to which the current baseline projections can then be compared. Moreover, the basis on which the agency could try to construct such a counterfactual baseline is unclear. With respect to the way Medicare pays certain providers, for example, CBO cannot determine the program rules and payment rates that the Centers for Medicare & Medicaid Services would have established over the past four years in the absence of the ACA. Moreover, CBO cannot determine how those program rules and payment rates under prior law would have affected the behavior of beneficiaries and providers—which in turn affects what federal spending would have been in the absence of the ACA. The basis for developing a counterfactual receipts baseline is also unclear because JCT cannot determine how taxpayers would have organized their financial affairs over the past four years in the absence of the ACA.

That problem is by no means unique to the ACA, nor is it related to developments regarding the implementation of the ACA that have surprised CBO and JCT. Indeed, judicial decisions and numerous administrative actions have caused the ACA's provisions related to insurance coverage to be implemented differently than CBO and JCT had initially expected, and, as noted above, the agencies continue to update their estimates of the budgetary effects of those provisions. Rather, the problem is common to all legislation that changes existing federal programs or tax provisions with results that cannot be clearly distinguished from what would have occurred under previous law.

Last year, in response to a question from a Member of Congress about whether CBO goes back to review its estimates of legislation in order to improve the accuracy of its methods ("The Accuracy of CBO's Budget Projections," blog entry, March 25, 2013, www.cbo.gov/publication/44017), CBO wrote:

> CBO routinely monitors the budgetary effects of enacted legislation to help improve projections of spending and receipts under current law, as well as to improve cost estimates for new legislative proposals. However, it is often difficult or impossible to determine, even in retrospect, the incremental impact on the budget of a particular piece of legislation ...
>
> The prescription drug program known as Medicare Part D is a relatively rare example in which actual spending can be directly compared to the projections contained in the CBO cost estimate. In most cases, legislation modifies existing programs; it is often not possible after enactment of such legislation to determine how spending for a modified program has changed specifically as a result of that legislation, or how much of future spending would have occurred even without the change in law. In contrast, the legislation that created Part D established a new component of Medicare with a system of new benefit payments, associated administrative costs, and payments from premiums and states. The actual net cost of Medicare Part D has been much lower than CBO originally projected.[3]

Moreover, determining the budgetary impact of previously enacted legislation that affects ongoing spending programs or tax receipts becomes more difficult over time as the conditions that would have prevailed in the absence of the original legislation become increasingly uncertain. Thus, in its estimate with JCT of the effects of a proposal to repeal the ACA in July 2012, CBO wrote: "Separating the incremental effects of the provisions in the ACA that affect spending for ongoing programs and revenue streams becomes more uncertain as the time since enactment grows."[4]

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3. However, CBO cannot assess the accuracy of its estimate of the entire Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173) because parts of that act modified existing programs; CBO is able to assess only the accuracy of its estimate of the cost of the provisions that established the prescription drug benefit under Medicare Part D.

4. See the letter to the Honorable John Boehner providing an estimate for H.R. 6079, the Repeal of Obamacare Act, July 24, 2012, p. 7, www.cbo.gov/publication/43471.

The largest changes in the estimated effects of the ACA during the past four years that CBO and JCT have separately identified are those associated with the estimated effects of the ACA's insurance coverage provisions and the elimination of the Community Living Assistance Services and Supports (CLASS) program. CBO and JCT's latest estimate of the cost of the coverage provisions is $100 billion lower than the March 2010 estimate for the period from 2014 through 2019 (2019 was the last year of the 10-year budget window used in the original estimate). CBO originally estimated that the CLASS program would yield federal budgetary savings of $70 billion through 2019 (and would have a budgetary cost in later years); however, the Secretary of Health and Human Services announced in 2011 that she did not "see a viable path forward for CLASS implementation." Combining the reduction in estimated cost of $100 billion and the loss of estimated savings of $70 billion with the original estimate that the ACA would reduce deficits by $124 billion over the 2010–2019 period yields a projected reduction in deficits of more than $150 billion over that period.

The costs and savings that can be attributed to other provisions of the ACA have undoubtedly been affected by many developments in the four years since the law was enacted. Economic conditions during the past four years and CBO's projections of the economy in coming years are different from what CBO projected several years ago. The health care and health care financing systems have continued to evolve, and health care spending—both in federal programs and in the private sector—has been below the amounts that CBO expected in early 2010. The implementation of the ACA has been guided by numerous regulations, some of which have differed from what CBO and JCT anticipated in their original estimates. For the reasons discussed above, however, CBO and JCT can no longer assess the budgetary effects of all of the provisions of the ACA without constructing a counterfactual benchmark.

Attempting to construct a counterfactual benchmark for the budget that excluded the ACA would raise significant challenges and would go beyond CBO's traditional role in the budget process. In particular, given the number and complexity of the changes to Medicare under the ACA, as well as the lack of data about what would have happened in Medicare without the ACA, creating a counterfactual benchmark for Medicare would be a very complicated task that would take months of work, and the resulting benchmark would be hugely uncertain and speculative. For example, constructing such a benchmark would require CBO to assess precisely what role the ACA has played in the slowdown in Medicare spending, and the appropriate analytical approach for making such an assessment is unclear. Moreover, the slowdown in Medicare spending has been part of a broader slowdown in national health care spending, and the effects, if any, of the ACA on that broader slowdown also would need to be taken into account in trying to construct a counterfactual benchmark.

Such challenges are why CBO traditionally has not produced retrospective estimates of the budgetary effects of enacted legislation but has produced cost estimates only for forward-looking legislative proposals relative to the current-law baseline. In that way, the agency has focused on its ongoing responsibilities to analyze pending legislation and to build models and other tools in preparation for analyzing future legislation.

*Estimating the Budgetary Effects of Repealing the Affordable Care Act.* Consistent with their statutory responsibilities, CBO and JCT can continue to estimate the effects of legislative proposals to modify provisions of the ACA or to repeal the law entirely. However, the agencies could not produce useful, timely estimates for proposals to repeal the ACA unless those proposals specified what would take the place of the law in areas where it modified preexisting programs and where those modifications have been under way during the four years since the law was enacted (in some cases, with further legislative modifications).

Consider again the ACA's changes to Medicare. In its estimate of the effects of a proposal to repeal the ACA in July 2012, CBO wrote: "[The proposal] does not specify how to implement the requirement that the provisions of law modified by the ACA be restored as if the ACA had never been enacted—for example, with regard to Medicare's payment rules and certain changes to the Internal Revenue Code that are already in operation. Because of that ambiguity, H.R. 6079 would cede considerable discretion to the executive branch to implement its provisions."[5]

That challenge is much greater two years later and will become still greater as more time passes. Because the ACA's changes to Medicare's payment rules have now been in place for up to four years, estimating the effects of a proposal that sought to repeal those provisions and largely delegated to the executive branch the task of determining what specific policies to implement instead would involve two steps: first, assessing what policies the executive branch would implement under such broad authority, and second, estimating the budgetary effects of those policies. In some cases, those policies might be quite similar to ones that would have been adopted under the law prior to the ACA; in other cases, those policies might be quite different from prior policies because of changes in the health care or health care financing systems that have occurred because of the ACA.

Given those challenges, projecting spending for Medicare under a proposal to repeal the ACA would be much more complicated and time-consuming—and the result much more uncertain and speculative—if the legislation did not specify an alternative set of policies to take the place of those established by the ACA. Similar considerations would apply to proposals to repeal many other provisions of the ACA, which have affected a wide range of ongoing programs.

Whether a proposal to repeal the ACA specified alternative policies or not, its budgetary effects would not simply be the opposite of the budgetary effects of the ACA itself. In its estimate with JCT of the effects of a proposal to repeal the ACA in July 2012, CBO wrote: "[We] also anticipate that some of the changes induced by the ACA in how public and private health insurance and health care programs are administered would be sustained" even if the law was repealed.[6] Two years later, that conclusion would probably apply even more broadly.

**Question:** On March 14, 2013, the Senate Budget Committee voted to approve the inclusion of section 502 of the budget resolution, S. Con. Res. 8, ultimately passed by the Senate as a whole:

> When the Congressional Budget Office releases its annual update to the Budget and Economic Outlook, the Congressional Budget Office shall provide an analysis of the budgetary effects of 30 percent, 50 percent, and 100 percent of Americans losing employer sponsored health insurance and accessing coverage through Federal or State exchanges.

5. Letter concerning H.R. 6079, p. 7, www.cbo.gov/publication/43471.

6. Letter concerning H.R. 6079, p. 8, www.cbo.gov/publication/43471.

The sensitivity analysis conducted by CBO in March 2012 does not reflect the significant changes to the law that have been made since it was compiled, including the July 2012 Supreme Court decision on Medicaid participation by the states, along with changes that CBO has included in other analyses, including the delay of various mandates and tax policy changes.

As this provision was supported by the majority of senators in passage of the budget resolution, please provide an update on the work that your office has done to provide the requested information.

**Answer:** In March 2012, CBO, along with the Joint Committee on Taxation (JCT), published *CBO and JCT's Estimates of the Effects of the Affordable Care Act on the Number of People Obtaining Employment-Based Health Insurance* (www.cbo.gov/publication/43082), which presented the results of those agencies' detailed analyses of the sensitivity of their estimates to variations in several underlying factors. At the time, the baseline estimates of the effects of the ACA's insurance coverage provisions indicated that between 3 million and 5 million fewer people, on net, will obtain employment-based coverage each year from 2019 through 2022 than would have done so under prior law. CBO and JCT presented four alternative scenarios, encompassing a wide range of variation in employers' behavior. Under those scenarios, the agencies estimated that enacrment of the ACA would change the number of people obtaining employment-based health insurance in 2019 by amounts that ranged from a reduction of 20 million to a gain of 3 million relative to what would have occurred otherwise—compared with a reduction of 5 million people in the baseline projecrion for that year. Those estimated changes were relative to an estimate of 161 million people obtaining such coverage in the absence of the ACA.

The budgetary effects of the four scenarios ranged from an increase of $45 billion in the net cost of the ACA's coverage provisions to a decrease of $82 billion in those costs, measured over the 2012–2022 period and compared with costs under the baseline that totaled about $1.3 trillion. In CBO's assessment, changes in the act's implementation and in CBO and JCT's estimating approach since that report was published have had little effect on the possible range of estimated budgetary effects associated with different offerings of employment-based coverage. Therefore, CBO concludes that the main findings of that report—that a sharp decline in employment-based health insurance as a result of the ACA is unlikely, and, if it was to occur, would not dramatically increase the cost of the ACA—still hold.

**Question:** As the CBO Long-Term Budget Outlook is an important and trustworthy implement for Budget Committee members in judging fiscal policy, please provide the following information based on its findings:

A version of Tab 1 of the Supplemental Data of the Long-Term Budget Outlook, "Summary Data for the Extended Baseline," with all values denominated in nominal dollars where they are now presented as a percentage of GDP.

A version of Tab 6 of the Supplemental Data of the Long-Term Budget Outlook, "Summary Data for the Extended Alternative Fiscal Scenario," with all values denominated in nominal dollars where they are now presented as percentages of GDP.

A version of Tab 1 of the Supplemental Data of the 2013 Long-Term Projections for Social Security: Additional Information, of Dec. 17, 2013, "Social Security Tax Revenues and Outlays, With Scheduled Benefits," with all values denominated in nominal dollars where they are now presented as percentages of taxable payroll.

**Answer:** CBO does not present long-term estimates in nominal dollars because, in the agency's judgment, such a presentation can be misleading. The key problem is that a dollar today means something very different from a dollar in the distant future, for at least two reasons. First, the cumulative effect of even low inflation over a long period can be quite large, so a dollar amount in the distant future will have much lower value than the same dollar amount today. For example, if inflation averaged 2 percent a year, the purchasing power of a dollar in 2085 would be a quarter of that in 2015. Second, the population, the economy, and people's incomes will all grow substantially over time, so a dollar amount in the distant future will be much smaller relative to the size of the economy or a person's income than the same dollar amount today. CBO projects that nominal gross domestic product (GDP) in 2085 will be roughly 20 times greater than nominal GDP in 2015, reflecting both inflation and inflation-adjusted economic growth over the next 70 years. Therefore, a dollar amount of federal spending or taxes that represented, say, 20 percent of GDP in 2015 would represent only about 1 percent of GDP in 2085.

Nevertheless, CBO's website provides long-term projections of GDP in nominal dollars as a help to those who might want to make calculations of nominal budgetary amounts. In the supplemental data accompanying *The 2013 Long-Term Budget Outlook* (September 2013, www.cbo.gov/publication/45308), column I of tab 2 provides nominal GDP projections through 2088; those amounts can be multiplied by any of the percentages of GDP shown in that report or provided in the supplemental data for that report to produce nominal dollar amounts.

### Senator Tim Kaine

**Question:** For the record, I would like to ask you to submit an answer to this question later, and that is, if over the next 10 years, instead of an 18.1 percent revenue to GDP we had a 19.5 percent, or whatever the average is of the 5 years when we balanced it, we had a 19.5 percent revenue to GDP, what would that do to the deficit projections over the next 10 years? And what would it do the projections of annual interest payments over the next 10 years? Now, I know that involves some assumptions that you could just up it to 19.5 without having cross-wind economic effects. But I just would like to know mathematically—because I believe what we have is not just a spending problem but a revenue problem. I would like to know mathematically, if we had revenue at 19.5 percent of GDP, what would that do to deficit projections and interest expense over the 2014 to 2024 period?

**Answer:** If revenues were to equal 19.5 percent of gross domestic product (GDP) from 2015 through 2024, rather than averaging 18.1 percent as projected in the Congressional Budget Office's February 2014 baseline, projected deficits would total about $4.2 trillion (or 1.9 percent of GDP) over the 2015–2024 period, compared with about $7.9 trillion (or 3.5 percent of GDP) projected in CBO's February 2014 baseline—holding all else equal. That difference in deficits of abour $3.7 trillion constitutes roughly $3.0 trillion of additional revenue and roughly $600 billion of reduced debt service. However, the increase in revenues contemplated in this scenario would have a number of economic effects, through its impact on people's incomes, on federal deficits and debt, and potentially on people's incentives to work and save (depending on the specific changes in revenue policy that were made). Those economic effects would have feedback effects on the budget, and those feedback effects are not incorporated in the numbers presented here.

**Question:** I would be interested over the course of 2014 to 2024 as to what is the projection of tax expenditures as a percentage of GDP and how that would change over the 10-year period.

**Answer:** On the basis of estimates prepared by the staff of the Joint Committee on Taxation, CBO projects that, under current law, all tax expenditures in the individual and corporate income tax systems will total roughly 8.2 percent of GDP in fiscal year 2014, if their effects on social insurance taxes as well as on corporate and individual income taxes are included. CBO estimates that the comparable total for 2017 is 9.0 percent. The agency has not estimated the magnitude of all tax expenditures beyond 2017, but the percentage of GDP for the years 2018 to 2024 is probably similar to the percentage estimated for 2017. By comparison, CBO projects that total federal tax revenue will be close to 18 percent of GDP during the coming decade under current law.

### Senator Angus King

**Question:** All agree that the most effective way to ameliorate the long-term deficit and debt problem is rigorous economic growth. Given this fact, which path is more conducive to such growth: selective federal investments or a continued policy of austerity defined as fixed revenues and cuts, either in discretionary or mandatory spending?

**Answer:** Both sound federal investment and reductions in federal deficits and debt can boost economic growth in the long term. Their relative effectiveness in achieving that goal would depend on the specifics of the federal investments or deficit-reducing policy changes that were adopted. In the short term, reducing federal deficits and debt would tend to lower economic growth, whereas increasing federal investment would tend to raise it.

Most federal investment for nondefense purposes contributes to the economy in the long term by improving the private sector's ability to invent, produce, and distribute goods and services. In contrast, federal investment for defense purposes contributes to the production of weapon systems and other defense goods but does not typically contribute to future nondefense output because much of it is narrowly focused on defense; the exception is the small portion of defense investment that funds basic and applied research.

Federal nondefense investment, done wisely, can contribute to private-sector productivity in various ways. Without public highways, for example, the cost to the trucking industry of delivering goods would be much higher; without government research and development (R&D), the Internet and whole segments of the economy would not exist; if not for receiving a public education (funded in part by federal spending), many workers would earn lower wages. In the view of the Congressional Budget Office, the government has made higher productivity possible in all of those cases by making investments that the private sector would not have made on its own or would have made in smaller amounts than their broad public benefits would justify.

The result of that higher productivity is a larger economy in the long term, all else being equal. However, the magnitude of the increase in economic output that would result from an increase in federal investment is highly uncertain. Moreover, the factors that contribute to the uncertainty present important considerations for policymakers who face decisions about how—and how much—the federal government should invest.

One factor contributing to that uncertainty is that federal investments differ greatly. The return on investments in transportation infrastructure, education, or research may be quite different, and the returns on investments of varied sorts within those broad categories may be quite different as well. Estimating those returns is difficult because it is challenging to ascribe particular outcomes to specific investments. Scientific and technological discoveries often build on past R&D, so it is difficult to determine what proportion of a new product results from any given investment. Similarly, workers' skills are the product of education funded not only by the federal government but also by state and local governments, the private sector, and the workers and their families. Moreover, realizing the benefits of federal investment may take many years, and the timing varies for different types of investment. A new highway can improve transportation as soon as it is built, but realizing the benefits of basic research or elementary education can take far longer, thus complicating the task of identifying those benefits.

In addition, the benefits of federal investment are unlikely to be distributed evenly. A business that is near a highway will probably enjoy greater returns from that highway than will a business that is farther away. Recipients of federal grants for R&D may acquire patents on their work, and although products and innovations based on those patents may benefit consumers, they also may earn returns for the patent owners that are not shared with the country as a whole.

Federal investment can have some negative effects as well. It can discourage investment by private entities or by state and local governments if it raises the price of investment goods. If that happens, and if the discouraged investment would have had positive economic returns, then the overall returns on the federal investment are lower. Furthermore, state and local governments may use federal funding for investments that they would otherwise have paid for with their own funds. (In some cases, however, federal investment can increase state and local investment, because some federal grant programs require investment by state and local governments as well.)

Reductions in federal deficits and debt will tend to increase output in the long term but decrease it in the short term, especially under current economic conditions. In the short term, policy changes that decreased federal spending or raised taxes (and thus decreased budget deficits) would generally reduce demand, thereby lowering output and employment relative to what would occur otherwise. That effect would tend to be especially strong under conditions such as those currently prevailing in the United States, with output so far below its potential (maximum sustainable) level that the Federal Reserve is keeping short-term interest rates near zero and would not be expected to adjust those rates to offset the effects of changes in federal spending and taxes.

By contrast, in the long term, policy changes that decreased budget deficits would generally increase national saving and investment, thereby raising output and income relative to what would occur otherwise. However, the economic effects would depend on the specific changes in tax and spending policies as well as on the magnitude of the change in deficits. In particular, the effects of policy changes on people's incentives to work and save and on federal investment could affect the economic consequences of any given change in deficits.

Thus, in the short term, economic output is likely to be higher if federal investment is increased than if total federal spending is reduced. The relative effects on output of those two approaches in the long term would depend on the specifics of the policies.

Policy changes that differ over time are possible, as are combinations of policies. For example, if policymakers wanted to raise gross domestic product both in the near term and in later years relative to projections under current law, they could devise a combination of policies that increased deficits during the first few years and decreased them by a greater cumulative amount thereafter (ultimately leading to less debt than would occur under current law).

**Question:** If selective federal investments are the preferred course, what are the most effective such investments (workforce training, education, infrastructure, others)?

**Answer:** Different federal investments—in areas such as education, including workforce training; R&D; and physical capital, including roads and other infrastructure—can promote long-term economic growth in different ways. In particular, education spending can develop a skilled workforce, R&D spending can prompt innovation, and spending on physical capital projects can bolster commerce. Such spending by the federal government can boost private-sector productivity by funding investments that the private sector would not have made on its own or would have made in smaller amounts than the resulting broad public benefits would justify. Depending on the type of investment, the benefits would be realized in different ways in the economy—for example, benefits might be realized sooner for some types of investment and later for others. A new highway can improve transportation as soon as it is built, but it may take longer to realize the benefits of investments in basic scientific research or elementary education.

The size and nature of the returns on the different types of investment are subject to considerable uncertainty, and the wide range of returns for any type of investment precludes saying which type is most effective. Realizing the potential gains from federal investments depends on successfully identifying the particular investments for which the benefits to society are expected to outweigh the costs.

**Question:** Assuming steady-state revenues—meaning that such investments would either increase short-term deficits or further crowd out current spending—which would be more damaging to economic growth: larger deficits, tax increases, or further cuts in current spending levels?

**Answer:** If policymakers decided to increase federal investments, they could finance those investments through reductions in other federal spending, increases in federal revenues, additional federal borrowing (that is, larger deficits), or some combination of those approaches. The effects on economic growth of those different approaches would differ over different time horizons and would depend on the specifics of the changes in federal revenues or spending that would be made.

In the short term, financing greater federal investment through additional federal borrowing would generally have a more positive effect on economic growth than would financing that investment through cuts in other spending or increases in revenues. Policy changes that increased budget deficits would generally raise overall demand in the economy, thereby bolstering output and employment in the short run relative to what would occur otherwise. Cuts in other federal spending or increases in revenues would at least blunt the increase in demand from the greater federal investment and might fully offset it or more than offset it, depending on the specific changes in policy. As noted above, the effect of additional aggregate demand stemming from changes in fiscal policy would tend to be especially strong under conditions such as those currently prevailing in the United States, with output so far below its potential level that the Federal Reserve is keeping short-term interest rates near zero and would not be expected to raise those rates to offset the effects of greater federal deficits.

By contrast, in the long term, financing greater federal investment through additional federal borrowing would generally have a more *negative* effect on economic growth than would financing that investment through cuts in other spending or increases in revenues. That result holds because policy changes that raised budget deficits would generally lower national saving and investment, thereby lowering output and income relative to what would occur otherwise. However, cuts in other spending or increases in revenues could also alter people's incentives to work and save, which would affect output and income as well.

**Question:** What is the lag time in terms of the increase in interest rates and effects on interest charges? In other words, if all of our debt today was locked in 10 years at 2 percent, an interest rate change next year would have no effect, as I see it, and I am just trying to understand what components of the debt are locked in and what are short term? Because I am concerned about this interest rate increase and the impact on the budget and the crowding out of other priorities, but there is a time lag thing here, isn't there?

**Answer:** The U.S. Treasury issues securities with various maturities to finance government activities. At the end of fiscal year 2013, 13 percent of its marketable securities were bills with a maturity of less than a year, 67 percent were notes with a maturity of 2 to 10 years, 12 percent were bonds with a maturity of 30 years, and 8 percent were inflation-protected securities with a maturity of 5 to 30 years. CBO projects that interest rates will rise over the next few years and that such increases will affect maturing bills quickly and other types of securities more gradually. About two-thirds of the government's marketable debt outstanding at the end of fiscal year 2013 is due to mature in the next 5 years.

Because of that maturity structure, an increase in interest rates would have a growing effect on federal interest payments over time. In Appendix D of *The Budget and Economic Outlook: 2014 to 2024* (www.cbo.gov/publication/45010), CBO estimated that an immediate increase in interest rates of 1 percentage point would raise interest payments on the debt that would have been issued in the absence of that increase by $38 billion in fiscal year 2015 and by $174 billion in fiscal year 2024. (Moreover, those additional interest payments would lead to the issuance of additional debt—unless changes were made to spending or tax policies—that also would receive interest payments; those payments would amount to a further $1 billion in 2015 and $72 billion in 2024.)

Chairman MURRAY. Thank you very much.

Dr. Elmendorf, let me start off by asking you a question about the role the overall economy plays in our efforts to address the deficit. Last week's CBO report describes how "lingering effects from the Great Recession and the subsequent slow recovery continue to dampen our economic potential." Relatedly, your report contains some very significant downward revisions to your expectations about the strength of our economy over the next decade, and the direct fiscal consequences of those revisions were pretty dramatic, about $1.2 trillion in added debt by 2024. That added debt is not from new spending programs or new tax cuts. It is purely because CBO now expects the economy to be weaker than it previously thought, correct?

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

Chairman MURRAY. Okay. So my question is about the importance of economic growth and building a strong economy and tackling our deficits and our debt. Certainly, we have to continue to work to reform spending programs and the Tax Code, but do you believe, given the large negative impact your economic revisions had on the budget projections, that fiscal responsibility also requires that we take measures that ensure we have a strong economy?

Mr. ELMENDORF. Yes, Senator. Any actions that the Congress can take to boost economic growth can have a very powerful effect on the future budget outlook. There are no plausible changes in economic growth that would make the long-term budget pressures go away. When we did our long-term budget outlook last fall, we looked at a range of alternative possible growth rates of the economy and interest rates and health care costs and so on, and the fundamental problem will remain. But the magnitude of the problem, the extent of the changes that would be needed in tax policy or spending policy or both, would be smaller if the economy were to grow more rapidly.

Chairman MURRAY. Okay. Last week, a rippling effect of the CBO report was the wide confusion about the section dealing with the impact of the Affordable Care Act on the workforce. That confusion actually was bad enough that the Washington Post fact checker examined some of the claims just 3 days ago. I do not know if you all saw it, but he called them "out of context," "deliberately misleading," and gave them three Pinocchios.

Now, as Chairman Ryan noted in the hearing last week, when you were before them, your report does not say that the Affordable Care Act is causing employers to lay off workers. In fact, the ACA is making it possible for people to be innovative and start new companies without being locked into a job or keeping longer hours just so they can have health insurance.

So can you please clarify this part of your outlook and specifically tell us are you saying that the ACA will cause 2.5 million people to lose their jobs, as some are claiming you said?

Mr. ELMENDORF. No, Senator. We would not characterize our results as saying that 2 or 2.5 million people would lose their jobs. I have not, to be honest, read all of the coverage that sprouted last week, but we took pains in a blog posting yesterday to emphasize the point we made in the appendix to the outlook last week that almost the entire effect that we are projecting comes not from people losing their jobs but from people choosing to work not at all or to work shorter hours.

Chairman MURRAY. Stay home and take care of their kids, start a new business, other things that families have that kind of choice.

Mr. ELMENDORF. A range of other activities, Senator, yes.

Chairman MURRAY. Can you talk a bit about how increased accessibility and affordability and availability of health insurance helps workers and specifically prevents what is known as job lock?

Mr. ELMENDORF. Yes, Senator. So the subsidized health insurance coverage that will be provided under the Affordable Care Act through both the expansion of Medicaid and through the initiation of tax credits to be provided for insurance bought through insurance exchanges, those subsidies make the people who receive them better off by raising their—by providing health insurance coverage at reduced cost to them. Some of them will respond to being better off by not working or working less.

In addition—and this is intrinsic to some extent in any program that provides benefits to lower-income people—those benefits are withdrawn under the Affordable Care Act as people's income rises. Lower-income people receive them and higher-income people do not. And that withdrawal of benefits creates an implicit tax that also reduces the incentive to work to some extent.

As you noted, the health insurance system as it existed prior to the Affordable Care Act also distorted people's labor market behavior relative to some ideal system in which health insurance was not related to work. And, in particular, there has been a substantial amount of research showing that people who had jobs and had particular health problems or concerns about the risk of health problems would then be unwilling to leave those jobs to take other jobs they might be more productive in if they thought they would lose their health insurance. That is the phenomenon known as "job lock," and that is a phenomenon that under the Affordable Care Act would not be there because people would be able to obtain health insurance through exchanges and possibly obtain subsidies for health insurance coverage.

Chairman MURRAY. Okay. Thank you very much. I really appreciate your clarification.

Senator Sessions?

Senator SESSIONS. Thank you. I think I understand, Mr. Elmendorf, your comments about the Affordable Care Act and hours lost and reduced. I would note that, from my perspective, what you have indicated is the act has a tendency to incentivize people not to work, and what we need in this country, in my opinion, is incentives to work, and that will help us be more productive. And we have to create systems, I think, to help people work even longer and reduce the amount they are drawing down their retirement benefits, extending and increasing their Social Security benefits if they can work longer, and we should be looking to do that.

Mr. ELMENDORF. Senator, we have analysis of the effects on the Federal budget and on the economy of raising the eligibility age for some programs to encourage people to work longer, as you are suggesting.

Senator SESSIONS. I think we have to talk about that, and you note that the big programs are the ones that are drawing a larger percentage of the taxpayers' revenue each year, are leading us and accelerating our debt course. I would just have to say, colleagues, that we are not going to be able to fix that and address it effectively if the President of the United States will not look the American people in the eye and tell them we have a problem that needs to be fixed. I wish it were different. But he has not done that, and we are not going to be able to achieve progress unless he does.

Just looking at your estimate of interest costs that we will be paying each year is rather stunning. Do you recall what the interest payment total was last year? Was is $240 billion or $250 billion that we actually paid out of our Treasury to—

Mr. ELMENDORF. Yes. So last year there were $221 billion in net interest, Senator.

Senator SESSIONS. So you project—and last year, last May, you projected 10 years from now, we would be paying $823 billion. This year, you project 10 years from today we will be paying $880 billion in one year, each of those one year in interest on the debt, which is over $500 billion more than we are now paying each year on the debt. Where does this money come from? That is the question I think the American people need to ask. It is going to come out of programs that people from both parties believe in, want to support, and want to see grow, and they are not going to be able to grow because we are going to have this huge increase in interest, the largest, fastest increasing part of our budget. Would you not agree fundamentally?

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

Senator SESSIONS. Now, you projected a couple of years ago, I believe, that if interest rates increased 1 percent, that would add a $1 trillion extra interest cost to the budget. This year, I believe you are saying that if interest rates increase 1 percent, it would add $1.5 trillion to the cost of the—to our budget cost. Is that correct?

Mr. ELMENDORF. Yes, Senator. If interest rates were 1 percentage point higher throughout the coming decade, we estimate that would add about $1.5 trillion to the Federal deficit.

Senator SESSIONS. And I teased you a little bit about missing some of your growth projections, but nobody knows for sure what interest rates will be 4, 5, 6, 8 years from now, do they? You just make the best estimates you can.

Mr. ELMENDORF. That is right, Senator, and your critique of our past economic forecast was quite correct. We missed the extent to which this recovery would be very slow. We had built in a slow recovery by the standards of the post-war U.S. period but not slow enough. And I think the people who had looked more carefully at financial crises in other countries over longer periods of time and said, "No, no, this kind of crisis takes a long time to recover from," were more right than we were.

Senator SESSIONS. Just briefly, since we cannot, in my opinion, continue to borrow more or to spend more to stimulate the economy, if we had a simpler Tax Code with a lower top marginal rate for corporate tax rate, as witnesses have said, would that help growth, be positive for growth?

Mr. ELMENDORF. Yes, Senator, and a tax reform that broadened the base and brought down rates in either the corporate or individual sides, or both, would be positive for economic growth. How much difference it would make would depend on the specific—

Senator SESSIONS. If we could identify regulations that were unnecessary and eliminate those, would that allow more growth to occur?

Mr. ELMENDORF. It might, Senator, but, again, the effects would depend very much on—

Senator SESSIONS. Well, experts tell us that regulations are adversely impacting growth. I would think so. If we produce more American energy and imported less, would that help growth in America?

Mr. ELMENDORF. Yes, Senator, I think it would, and we are in the process of working on an analysis now of the effects of fracking on the U.S. economy and on the budget, and we hope to—

Senator SESSIONS. If we could reform our 80 or so means-tested social programs and to focus more on incentivizing and training people to work and to move out into the employment field, would that improve America's GDP growth?

Mr. ELMENDORF. Yes, I think it would, Senator. Again, the effects would depend very much on the specific changes—

Senator SESSIONS. And if we had a leaner, more productive Government, just the money that came into this United States Government, we got more for it for our citizens, would that be good for growth?

Mr. ELMENDORF. Well, getting more effective Government services or more benefits per dollar of tax revenue would be good for people by receiving more benefits or services—

Senator SESSIONS. And if we—

Mr. ELMENDORF. —for growth depends on a lot of the—the timing of the changes and the nature of the changes.

Senator SESSIONS. And if we brought our deficits under control, would that create more confidence and more growth in the future?

Mr. ELMENDORF. Reduction in the long-term projected deficits would be good for the economy in the long term and we think in terms of people's confidence today, Senator.

Senator SESSIONS. Thank you.

Chairman MURRAY. Senator Sessions—I mean, sorry, Senator Stabenow.

Senator STABENOW. Thank you very much, Madam Chair. You know, listening to the debate on the budget and the numbers, I think for people watching this today could scratch their heads because you can look at things so many different ways.

I want to back up and just start with some good news and if, in fact, bringing down the deficit increases economic activity, we ought to all be celebrating today. Mr. Elmendorf, when you say that in 2009 we had a $1.4 trillion deficit, this year it will be $500 billion—did I hear you say that?

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

Senator STABENOW. Yes. So that is a pretty big drop. A pretty big drop.

Mr. ELMENDORF. Yes, Senator.

Senator STABENOW. And we should actually view that as good news. And, in fact, it is good news. It may not be good politically for folks that want to use the issue, but it is good news.

We also have seen 8.5 million private sector jobs. We need more, but certainly in the last few years, and that is a good thing.

Do you stand by your statement that says in your report, "In CBO's judgment, there is no compelling evidence that part-time employment has increased as a result of the Affordable Care Act"?

Mr. ELMENDORF. Yes, we stand by that, Senator.

Senator STABENOW. Yes, thank you. So, in fact, what we are seeing is job growth, and what we need is more of it.

One of the things that is concerning to me in your numbers for us as policymakers is that you have indicated that in discretionary spending—our investments in education, opportunity, rebuilding America, infrastructure, innovation, those things that we do to compete in a global economy—that in the next 10 years we will see the lowest investments in those things that affect people and opportunity, economic development, since 1940? Did I hear you correctly?

Mr. ELMENDORF. So the specific fact, Senator, was that all of Federal spending, apart from Social Security, the health care programs, and interest on the debt, so the rest includes defense spending, non-defense discretionary spending, and the other benefit programs and mandatory spending, that collection of programs together, spending will be smaller as a share of the economy in 2024 under current law than at any point since at least 1940.

Senator STABENOW. So when we are looking at a global economy competing with China, with those around the world investing like crazy to lower their costs of college, to build their countries, to invest in clean energy and so on, we in America are actually going in the opposite direction. And I want to underscore that when you talked about economic growth mitigating some of the other factors—obviously we care about long-term deficits; obviously we want to continue to stay on a path of fiscal responsibility. But certainly growing would do an awful lot, creating jobs would do an awful lot to mitigate that.

My questions, I want to go back just one more time, because I feel like we are speaking two languages here on the Committee as it relates to the Affordable Care Act, so I want to go back just one more time and ask you, as it relates to the ability for people to have freedom to dream big dreams and make decisions without being chained to their desk or their job, one more time: Did the February 2014 report on the budget and economic outlook find that the affordable health care law will end 2.5 million jobs?

Mr. ELMENDORF. What we found, Senator, was that about 2.5 million—we found that people would reduce their work effort by the equivalent of about 2.5 million full-time equivalent positions, but—

Senator STABENOW. Okay. But is that 2.5 million jobs that we would lose?

Mr. ELMENDORF. We did not say that 2.5 million people would lose their jobs.

Senator STABENOW. Or that we would lose 2.5 million jobs in the economy?

Mr. ELMENDORF. We have not quantified the ultimate effect on employment. I want to be careful here, as you say, Senator. We think that when people talk about—outside of economic and budget people-talk about people losing their jobs, they mean people who are laid off from jobs they want to keep. What we describe in our report is almost entirely people who are choosing to work less or not to work because of the extra benefits they will receive under the Affordable Care Act and the withdrawal of those benefits as incomes rise. That is a reduction in the supply of labor that is driving the change, and the amount of the change is ultimately a reduction, an equivalent to 2.5 million full-time equivalent positions.

Senator STABENOW. So we are giving people more choices, just like the ones that exist for the very wealthy and live off investments, who can choose whether or not to be actively in the workplace or not or to do other things, philanthropic things, or to spend time with their family. We are giving a choice to someone in my family, in fact, right now where this is very real who wants to stay home with her 18-month-old and has not been able to do that because her family's health care comes from her job as opposed to her husband, who is in small business. And so they are going to have a different kind of freedom to be able to do something I would argue that is just as productive, which is to raise a little boy and have mom at home.

Mr. ELMENDORF. So, Senator, as we were clear yesterday, we are not judging the—

Senator STABENOW. No, I appreciate that.

Mr. ELMENDORF. —value of the good things they are choosing to do. We are just—

Senator STABENOW. I appreciate that. No, I am actually evaluating—

Mr. ELMENDORF. —economics of the situation.

Senator STABENOW. Yes. What I am doing is adding the evaluation, which is moms or dads being able to be home with little ones has tremendous value for their family and for all of us, and I am so proud that we are going to be able to give moms and dads that choice.

And then, Madam Chair, I know my time is out, but on the other end, also in my family are individuals that are going to be able to retire from some very, very hard work a little bit early, in one case develop the small business they have been hoping to for a long, long time. So I think the freedom involved in folks being able to make choices is one of the wonderful things about moving forward and not having health care have to be tied to employment.

Thank you, Madam Chair.

Chairman MURRAY. Thank you.

Senator Grassley?

Senator GRASSLEY. I want to continue that discussion, but I want to look at the macroeconomic impact rather than the specific number of jobs. I would like to ask you about the lackluster economic recovery in the labor market. We already know that the labor force participation rate is at the lowest point since 1975, although I guess last month it ticked up just a hair. CBO now projects that the Affordable Care Act would reduce the number of full-time equivalent workers by about 2 million by 2017, 2.5 million by 2024, obviously a result of some people choosing to not work at all or others choosing to work less. The fact is, it is a disincentive for some people to work, resulting in a decrease of labor supply.

So getting to the questions, to grow the economy and increase economic opportunities, we need more workers and ought to encourage people to work. What effect will this have on the economy and GDP growth?

Mr. ELMENDORF. So, Senator, the reduction in the supply of labor that we estimate would result from the Affordable Care Act pulls down GDP, pulls down investment, pulls down tax revenues relative to what would be the case otherwise.

Senator GRASSLEY. So, simply put, it is not in our economic interest to shrink the size of the workforce.

Mr. ELMENDORF. Well, it is not in the interest of GDP to reduce the workforce. Of course, how we value GDP—

Senator GRASSLEY. Well, GDP is more for more people, and if we are going to have lower GDP, we are going to have more people in this country, and more people are going to have less. You have to expand the economic pie. It seems to me like it is very basic to Americans to have more for more people.

Finally, then, would it be fair to say that discouraging people to work is harmful to our economic growth and diminishes individuals' economic opportunity?

Mr. ELMENDORF. It is harmful to our economic growth, Senator. I do not want to speak to how an individual feels about this because there are pros and cons. But it does reduce our economic growth, absolutely.

Senator GRASSLEY. Thank you. According to CBO, Federal revenues are expected to reach $3 trillion this year, or 17.5 percent of the economy, which is just a little bit below a 40-year average. Over the 10-year window, revenues are expected to grow at the same pace as the economy and average about 18.1 percent of GDP. Conversely, Federal spending for 2014 will be 20.5 percent of GDP, which matches about a 40-year average. CBO projects the outlays will grow faster than the economy over the next decade and will equal 22.5 percent of GDP by 2024.

What is the economic impact of spending that consistently outpaces revenue? And, secondly, doesn't this demonstrate that we have a spending problem that is fiscally unsustainable?

Mr. ELMENDORF. Yes, Senator. We think the Federal budget is on an unsustainable path. As you understand, when spending outpaces revenues for prolonged periods of time, especially after we get out of this current economic downturn, then that extra—those deficits lead to an accumulation of Federal debt. That debt crowds out some private capital investment, which reduces GDP and wages and incomes relative to what they otherwise would be.

In addition, as I noted, the rising debt reduce your and your colleagues' flexibility to respond to unexpected challenges that arise and raises the risk of a fiscal crisis down the road.

Senator GRASSLEY. Since CBO's previous baseline budget projection of May 2013, you have raised the estimate of the cumulative deficit between 2014 and 2023 by $1 trillion. According to CBO, most of the increase in projected deficits results from lower economic growth and, thus, lower tax revenue.

First question: Can you describe what economic factors have led to the lower economic growth projections? And, secondly, can you describe what impact the Federal debt at 79 percent of the economy will have on economic growth?

Mr. ELMENDORF. So, Senator, the second question first. The high amount of debt, the historically high amount of debt that we project throughout the coming decade will diminish economic growth by the end of the decade by crowding out some capital investment and reducing our ability to produce.

The downward revision to our projection of GDP actually stems from a large collection of factors, no one of which was dominant but almost all of which ended up going in the same direction. And we looked at revised data from the Bureau of Economic Analysis and the comprehensive revision to national income accounts last year. We reassessed how close we thought actual output would get to potential output by the second half of the decade. Historically, in fact, there has been some shortfall there, and we built that into our projection this time.

We took a new look at the effects of the Affordable Care Act on the labor force, as we have been discussing, and a number of other factors as well. And the collection of those factors brings down, by our estimate, real GDP, inflation-adjusted GDP, by 2 percent at the end of the 10 years relative to what we thought before. We have also brought down the price level so that nominal GDP in our projection is 3.5 percent below what it was before. And that is the dominant factor in our upward revision to projected deficits.

Senator GRASSLEY. Thank you.

Thank you, Madam Chairwoman.

Chairman MURRAY. Thank you.

Senator Whitehouse?

Senator WHITEHOUSE. Thank you, Chairman. Welcome, Dr. Elmendorf.

Mr. ELMENDORF. Senator.

Senator WHITEHOUSE. We are having an ongoing discussion in the Senate about extending unemployment insurance. In Rhode Island, I just flying down sat next to a lady who has a friend who sort of meets the profile that we are talking about. She has worked all her life, and she was not able to retire, and she lost her job, and she is in her 50s, and it is very hard for her to find employment. It is through no fault of her own whatsoever. She is constantly looking for work. In Rhode Island, we still have a 9-percent unemployment rate, and if you put the number of people looking for work against the number of jobs, there is just no way you can make it fit.

And we are also hearing that if you extend unemployment insurance, that will have an unhelpful effect on our employment numbers because really these are lazy people who are out there goofing off, and if they just got a good, solid swat from having their unemployment insurance benefits cut off, then they would get back to work. That is what—

Mr. ELMENDORF. That is not what our analysis shows, Senator.

Senator WHITEHOUSE. Indeed, your analysis seems to show the exact contrary. Could you tell us what your analysis shows of what the effect of extending unemployment insurance benefits would be on national unemployment levels?

Mr. ELMENDORF. So, Senator, our analysis suggests that if the emergency unemployment benefits were extended through this year, that would raise real GDP by two-tenths of a percent at the end of the year and would increase full-time equivalent employment at the end of the year by about 200,000 positions.

Senator WHITEHOUSE. So put the other way, to reverse what you just said, the Republican insistence on blocking even a paid-for unemployment insurance extension is costing this country a 0.2 percent GDP growth and is costing—will cost 200,000 jobs if it is not resolved.

Mr. ELMENDORF. Senator, I can only repeat our analysis. Your attribution of consequences to particular people is beyond the scope of my position.

Senator WHITEHOUSE. But it does have that effect. Those are the effects that you have quantified.

Mr. ELMENDORF. The effects that we wrote about in a letter to Congressman Van Hollen in December remain our estimates, and we repeat some of them in the report we released last week.

Senator WHITEHOUSE. Well, on the strength of that, I would take this opportunity to urge my Republican colleagues, who came within one vote of doing this—we are one vote away from adding 0.2 percent to GDP and 200,000 jobs to the economy by doing the right thing for people who are out of work through no fault of their own. And how we are at a place where that is not something we can work together to get done I think is a sad commentary on politics in Washington.

My time is running out, so let me close. I hear my colleagues on the other side talk about the debt and the deficit and say how—you know, to use words that were used today—this is a problem that needs to be fixed. And the enthusiasm and the passion and the militancy with which our colleagues on the other side pursue the debt and the deficit problem I think is commendable. What concerns me is that that passion and that militancy and that determination evaporates as soon as you are talking about benefits that go out to wealthy folks and to corporations through the Tax Code.

We are, I think, more than happy to work to reduce our debt and deficit, but it is impossible for me to look at adding to the cuts that we have applied to middle-income families and to investments like infrastructure and scientific exploration and innovation, and at the same time be protecting the right of the hedge fund billionaire to pay a lower tax rate than a brick mason in Rhode Island.

And my test of when our colleagues are going to be actually serious about the debt and the deficit is when it is no longer less important than protecting carried interest for hedge fund billionaires. As long as the primary thing is to protect that tax benefit and a horde of others that go to high-end and corporate politically influential people, you cannot put those to me side by side and say that we are actually really all that serious about the debt and the deficit. You are only as serious about the debt and deficit as you are putting it in relation to other things, and put in relation to protecting hedge fund billionaires paying lower tax rates than brick masons to me puts a context into that claim.

Thank you.

Chairman MURRAY. Senator Toomey.

Senator TOOMEY. Thank you, Madam Chairman.

Well, first let me say, Dr. Elmendorf, thanks for being here, and I just want to compliment you and your team. My staff and I have on numerous occasions turned to your office for help when we are wrestling with legislative challenges. Whether it is potential changes to the Flood Insurance Program or granting the administration some flexibility in managing through a difficult sequester, your staff has consistently and timely been responsive in helping us to understand the budgetary implications, the scoring implications, and that is a very, very helpful service. So you have a great team, and I want to thank you for that.

Mr. ELMENDORF. Thank you very much, Senator. That means a tremendous amount to all of us.

Senator TOOMEY. Well, they do a great job.

I do have to say I am shocked, have been since last week—not by your analysis that suggests that if you increase incentives to leave the workforce, some people will, in fact, leave the workforce. That is not shocking. That is not revolutionary. What is shocking to me is my colleagues suggesting that this is a great thing, that it is somehow a good thing to diminish the incentives to work. I do not know how we got to the place in America where work has become a terrible thing that we must unshackle people from the misery of having to be productive and from actually supporting their family. And I do not know how it is lost on so many people in this town that work is a source of dignity and it is the way people get ahead. And it has always been the source of advancement in our society.

I am not asking you to comment on that. I think you would probably rather not. But I do want to be clear. Your analysis about the effects, the result from the incentives of Obamacare, your analysis says that we will have a smaller workforce as a result. Correct?

Mr. ELMENDORF. Yes, absolutely.

Senator TOOMEY. And a smaller workforce means a smaller economy.

Mr. ELMENDORF. Yes, that is our estimate, Senator.

Senator TOOMEY. So your analysis is that, as a result of this phenomenon, we have less total output, and I think it is very clear that that means less opportunity, less prosperity.

One of the things that is really disturbing about your projections is how meager the economic growth forecast is. For most recent decades—I am not sure exactly what the time frame I have here is—actually, I guess about the last 60 years or so, even including the Great Recession, average real GDP growth has been over 3 percent. You are projecting that starting from next year forward it just gradually declines every year, every single year, until we get to about 2 percent, which is well below our historical average. And what that means is just fewer people working, fewer people getting raises, fewer people advancing in a lower standard of living. Isn't that what it means to have a 2-percent GDP growth instead of a 3-percent GDP growth?

Mr. ELMENDORF. So let me just be clear here that the thing that slows throughout the decade is the growth of potential output. We think there will be some recovery of actual output up to our potential as we continue the recovery. But then potential output growth, you are right, Senator, we think will be much lower in the future than in the past. The most significant part of that is the demographic change. It is the retirement of the baby boomers. But there are other factors as well.

Senator TOOMEY. Well, there are, and, in fact, you knew very well the demographics of the aging population last year. That has not changed in the last year. Demographics are very immutable. But yet you have reduced your forecast for the actual size of our—in fact, you reduced it so much between last year and this year, it is $1 trillion, which is a hard number to—roughly $1 trillion in 2024. It is hard number to wrap your brain around, so one way to think about it, that is the total economic output of Pennsylvania, West Virginia, Delaware, and Maryland combined. That is how much you have diminished your forecast of economic growth in 2024.

So could you share with us the main reasons that you think our economy is going to be so much smaller now than you thought a year ago?

Mr. ELMENDORF. So there are a large collection of factors, Senator. Part of it was that the national income accounts data were revised last summer, and that affected our view of how much output had grown in the past. It affected our view of what productivity growth was likely to be going forward. There were new data that changed our view of how much the labor force had grown in the past. So a lot of factors.

We also did, as we have discussed, a re-evaluation, a very intensive examination of the effects of the Affordable Care Act. And so this collection of things, it turned out that the revisions were largely in one direction. But we do think our current projection is the best one that we can give you at this point in time, recognizing tremendous uncertainty—

Senator TOOMEY. But a significant contributing factor is the decline in the total workforce participation rate. Isn't that—

Mr. ELMENDORF. That is absolutely right. If you look at the—the most significant factor explaining why growth will be slow in the future relative to the past is slower growth of the labor force. And that is partly the retirement of the baby boomers. It is partly that the big increase in women's participation in the labor force in the 1970s and 1980s will not be repeated.

Senator TOOMEY. Right. But you knew that last year. I am talking about—

Mr. ELMENDORF. We knew that last year.

Senator TOOMEY. —the difference from this year to last year.

I see my time is out, and I appreciate your answers, Dr. Elmendorf. I would just suggest that since the Great Recession, we have been in this great experiment with virtually and in some ways completely unprecedented governmental policies, massive expansion in regulatory burdens imposed on the economy, huge tax increases, massive surge in spending, which has since declined somewhat but is projected to grow again, completely unprecedented monetary policy. And I would just suggest that the data that is coming in is indicating this is not working so well, and the forecast is for it to get worse. I hope we will get off this path.

Thank you, Madam Chairman.

Chairman MURRAY. Senator Kaine.

Senator KAINE. Just quickly, by way of introduction, there is a lot of food for thought in this, Senator Toomey's comments about, you know, does the ACA disincentivize work. The way I look at it, the Federal Government has been disincentivizing work for a long time. I mean, it used to—through tax policy. We used to tax investment income at a rate that was less than wage income—I am sorry. We used to tax investment income at a rate significantly higher than salary and wages. Then they reached a rough equivalence, and now we decide to tax work much heavier than we tax investment income. So if we are going to look at what disincentivizes work, we need to tackle the tax expenditure issue. That is my editorial comments.

The questions I want to ask, to make sure I understand the report, deal with revenue as a percentage of GDP and spending as a percentage of GDP.

Dr. Elmendorf, as I read the report—and this is pages 79 and 80—on revenue as a percentage of GDP, the 10-year average you project from 2014 to 2024 is about 18.1 percent. It varies over the 10 years, but that is the average.

Mr. ELMENDORF. Yes.

Senator KAINE. The 40-year average going back essentially to the start of Medicaid and Medicare 40 years, is 17.5 percent. So the next 10 years we are projecting to be somewhat higher. But on the five times when we have had a balanced budget, the average of revenue to GDP is between 19 and 20 percent. Is that correct?

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

Senator KAINE. For the record, I would like to ask you to submit an answer to this question later, and that is, if over the next 10 years, instead of an 18.1 percent revenue to GDP we had a 19.5 percent, or whatever the average is of the 5 years when we balanced it, we had a 19.5 percent revenue to GDP, what would that do to the deficit projections over the next 10 years? And what would it do the projections of annual interest payments over the next 10 years?

Now, I know that involves some assumptions that you could just up it to 19.5 without having cross-wind economic effects. But I just would like to know mathematically—because I believe what we have is not just a spending problem but a revenue problem. I would like to know mathematically, if we had revenue at 19.5 percent of GDP, what would that do to deficit projections and Internet expense over the 2014 to 2024 period?

Mr. ELMENDORF. We will provide you that answer, Senator.

Senator KAINE. Similarly, on spending, which is at pages 49 and 50 in your report, you project from 2014 to 2024 that spending will go from 20.8 percent of GDP to 22.4, and the components of that are also interesting: Social Security from 4.9 to 5.6; major health programs, Medicare especially, from 4.8 to 6.1; other mandatory programs dropping from 2.5 to 2.2; discretionary programs really dropping from 6.4 to 5.2; interest payments going up as a percentage of GDP from 1.3 to 3.3.

For the record, I would like to ask you to calculate where tax expenditures fit in this component. In your section in the CBO report on spending, you do not have tax expenditures. You would consider that more on the revenue side. But based on the work that we have done on this Committee and the Chairwoman's opening statement that the tax expenditures are virtually larger than any other programmatic line item, and they are every bit as much, quote, entitlements as other entitlement programs. Unlike the budget that we battle every year how much to put into Pell grants, so often these tax expenditures get put in the codes, and then we just, you know, let them go forever. I would be interested over the course of 2014 to 2024 as to what is the projection of tax expenditures as a percentage of GDP and how that would change over the 10-year period. I know that involves some assumptions, too, assumptions about congressional behavior, will tax expenditures be extended, et cetera. But obviously you have built some of that into your revenue projections, anyway, and I would like to see the magnitude of tax expenditures as a percentage of GDP, as a follow-up question for the record, if that is okay.

Mr. ELMENDORF. We are happy to do that, Senator. I will say that we have a discussion of the tax expenditures in the revenue chapter of the report. We note there that the 12 largest tax expenditures, which are about three-quarters of the total dollars, would total about 6.5 percent of GDP over the coming decade.

Senator KAINE. So if the 12 largest are 6.5 percent of GDP and they are three-quarters, then you are probably talking about a total of like 9 to 9.5 percent of GDP if you put all the tax expenditures—

Mr. ELMENDORF. I think that is right. I think we have not projected all of them out over the entire decade, which is why we put it that way. There is a widespread consensus among analysts that tax expenditures have the same types of effects on the budget and on the economy as many types of direct Federal spending and, thus, should be viewed comparably by analysts and by policymakers.

Senator KAINE. They cost money, but they can also kind of warp market behavior. I would love that answer with all of the tax expenditures added in, but just if I am doing the math right, for the 12 largest at 6.5 percent or three-quarters of the total, and so the actually total is closer to 9.5 percent, I mean, that is significantly larger than Social Security, significantly larger than Medicare and other health programs, and almost double of what the discretionary budget would be over the next year. So I would just ask you to submit that answer for the record.

Mr. ELMENDORF. Yes, Senator.

Chairman MURRAY. Senator Johnson.

Senator JOHNSON. Thank you, Madam Chair.

To start out with, there are a number of things I agree with you in your opening comments. You said that we really want to drive for opportunity growth. I think we have pretty well established, I think, in the testimony that the Affordable Care Act is going to decrease economic growth by shrinking our labor force. I also agree that we need to address our long-term fiscal challenge.

I disagree with the way you typify certainly what folks like me want to do in terms of a debt ceiling. It is not about demanding a ransom. It is about trying to instill, if we are going to increase the debt burden on our children and grandchildren, I think most Americans would expect us to at least enact some reforms to the long-term entitlement programs, you know, instill some additional fiscal discipline.

So let me start out there, Director Elmendorf. If we stopped deficit spending today—and I realize that is kind of a long shot. If we stopped deficit spending today, other than maybe some short-term cash flow problems, there would be no reason whatsoever to increase the debt ceiling. Correct?

Mr. ELMENDORF. Well Senator, as you know, the unified budget deficit does not capture all the forces that lead to an increase in the debt subject to limit.

Senator JOHNSON. Okay. There could be some cash flow issues. There can be some work—I got that. But, in general, in terms of how much, how dramatically we are having to increase the debt ceiling, by and large the reason we have to increase the debt ceiling is because we continue to deficit spend. Correct?

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

Senator JOHNSON. Okay. I have a chart up here, because I think as a problem solver myself, the first step in solving a problem is you have to admit you have one. And when I hear people say that Social Security is solvent to the year 2033, I challenge that assumption. And the next step is you have to properly define it, and I would continue to argue that we do not have a 10-year budget window problem; we have a 30-year demographic problem.

What we have done with your CBO estimates is, you know, everything you do is basically a percentage of GDP, or most of what you do, which certainly I found in talking to my constituents, they do not quite—that does not really do it for them in terms of understanding the problems.

So what we have attempted to do—and I would certainly like your input, and I want to make sure that we are getting this right, but off of the latest CBO projections, we have taken those percentages of GDP, put numbers to them, this is what we come up with over the next 30 years; in other words, deficit spending of $8 trillion in the first decade, $31 trillion in the second decade, $88 trillion in the third decade—for a whopping total of $127 trillion.

And I want to first focus on Social Security because I appreciated during our December budget conference committee hearing when I was just kind of going through the practicality or the reality of the fact that, yes, the Social Security Trust Fund holds right now $2.7 trillion of Government bonds, but the Treasury has that offsetting liability which nets to zero. And your CBO projections of basically deficit spending in the Social Security Trust Fund—in other words, the amount of benefits we are going to pay out that exceed the payroll tax, it is about $15 trillion. Is that largely correct?

Mr. ELMENDORF. We have not done the calculation in dollar terms as you have, Senator, but it certainly would be a large number, and I would defer to your calculation.

Senator JOHNSON. Well, I tell you what. It seems that you are being very cooperative with Senator Kaine in terms of providing those types of calculations. We have been asking—and your staff has been helpful, but I would really like the CBO to start converting these percentages of GDP. You do provide long-term GDP figures in dollars. I think if you convert all the rest of your alternate scenarios and baselines in dollars, that would be extremely helpful.

Mr. ELMENDORF. As you know, Senator, we focus on shares of GDP because we think that nominal dollars have less and less meaning as one goes further and further out. We project that GDP over the coming decade will be more than $200 trillion in aggregate. So we find that these sorts of numbers without the context of the size of the economy around them have the potential to be—

Senator JOHNSON. But you—you know, so—but it is all relative. So you publish the dollar amount of the size of the economy. So in 30 years, the size of the economy, according to your numbers, will be $64.8 trillion, and, you know, so off of that, percentage of GDP, what we are coming up with is the deficits, the cumulative deficit over that time period would be $127 trillion. Our debt at that point, based on those projections, by the way, would be—I have it—about $128 trillion divided by the $64.8 trillion economy, would be 197 percent debt held by the public as a percentage of GDP. Those are real scary numbers.

Let me put this further into context. Then I will be done.

To put that number into context, because I realize trillions of dollars are just incomprehensible, currently the net private asset base of America, all assets held by businesses, large and small, and households is about $96 trillion. So in the next 30 years—which, by the way, my little baby is now 30 years old, and that went by [snaps fingers] like that. So the relevant time frame, the baby-boom generation retiring, all these benefits we promised and we have not made adequate provisions to pay for it, that long-term fiscal challenge that Madam Chair talked about us addressing, the only way we are going to address that is if we admit we have the problem, we start properly defining it, and put it in the terms that the American people understand. Percentage of GDP is not a term or a way of presenting this that the American people understand. I think they will start getting that, and if we start talking in these terms about the real danger facing this Nation, we just might have an opportunity to, in a bipartisan fashion, get everything on the table and start working toward real solutions so we stop mortgaging our children's future.

Thank you.

Mr. ELMENDORF. Thank you, Senator.

Chairman MURRAY. Senator Baldwin.

Senator BALDWIN. Thank you, Madam Chairwoman and Ranking Member Sessions. Thank you, Dr. Elmendorf, for being here.

A lot of the terrain that I intended to cover has already been covered by my colleagues, but I thought I would still like to visit it with perhaps a Wisconsin face.

Starting with the report on the impact of the Affordable Care Act on people choosing to leave the workforce, to me this brings me directly to a bunch of very hard-working people who I have been proud to represent, both in the House and the Senate, for many years, and I think of family dairy farms. For so many years, one of the family has usually had to leave the farm to work solely to bring in health insurance, whether it is because of the pre-ACA rules whereby insurance companies could deny coverage with preexisting health conditions or simply the risks and actuarial risks associated with covering a small organization in a risky business. And that story has repeated itself—you know, I have met so many folks that are in that situation, and I think about the fact that they may, now that they can get family health coverage in a marketplace, choose to leave those jobs, and that that will be counted in one way, but I can assure you, when they return full-time to the farm, they will be working, both investing their efforts and labor in raising their families, caring for senior relatives, but also engaged in the economic activity of the farm.

And I appreciated your blog entry the other day trying to bring greater clarity to what sort of movement in and out of the workplace this is, that, you know, when somebody is laid off, we mourn and we are upset, but when somebody chooses to leave in this sort of manner, whether it is retiring or doing what they really want to be doing, work in their family enterprise, that is more of a reason for celebration.

I also note in the report on the slow recovery of the labor market, some of the recent numbers on the number of job seekers per job opening that exists—of course, we reached a huge peak in, I guess, 2009 of 6.7 job seekers per open job, and then dropped to what is now I guess 2.7—

Mr. ELMENDORF. Yes.

Senator BALDWIN. Somewhere I have been hearing between 2.7 and 2.9 in the fall of last year. And so I know it is not a part of your Affordable Care analysis to talk about what happens when people do leave the job market or leave jobs because they can secure health insurance. But is it reasonable or logical to assume that there will be 2.7 people today looking to seize that opportunity if that displacement and dislocation occurs?

Mr. ELMENDORF. Yes, Senator, the effects of changes in the supply of labor are very different under the economic conditions we face in the country today, where there is, as you noted, a large excess of people looking for jobs who cannot find them, than the effects that that reduction in labor supply will have later in this decade when we think that the job market will have tightened considerably.

Under current economic conditions, where really it is the demand for labor that is limiting the level of employment, changes in the number of workers does not have much effect on the actual ultimate level of employment. However, by later in the decade—I think that is the point you are referring to, but I want to emphasize, later in the decade, when the job market will have tightened, that is a point at which we think changes in the labor supply really will translate into changes in the number of people who are employed, because we think that this 2.7 number will come back down to the more standard level we have in the labor force, just given the normal turnover.

Senator BALDWIN. And I know that my time is running out, so I just briefly want to associate myself with some of the previous comments on our ongoing debate on extending emergency unemployment benefits long-term unemployment benefits. When you were last before the Committee, we actually engaged in a conversation based on the Federal Reserve paper on the long-term unemployed and how they have become less attached to the workforce and have lost skills they once held and present other real challenges.

I just have to say, when this emergency unemployment compensation lapsed at the end of December, the statistics in Wisconsin are about 23,700 Wisconsinites lost benefits. It is supposed to, if let continue throughout the year, hit somewhere close to 99,000, and we know the statistics nationally.

The stories are heartbreaking—foreclosure, I hear from folks on the number of jobs they have applied for, the budgets that they have been trying to live on with unemployment assistance and what that will mean to not have it.

I guess I just would ask, is it correct to state that extending unemployment insurance is one of the most cost-effective ways to stimulate a weak economy?

Mr. ELMENDORF. Yes, that is right, Senator. A report that we did a couple of years ago about a number of alternative possibilities that you and your colleagues could pursue to strengthen the economy and add jobs in the short run, expansion of unemployment insurance benefits was the most cost-effective item on that list.

Senator BALDWIN. Okay. Thank you.

Chairman MURRAY. Senator Ayotte.

Senator AYOTTE. I want to thank the Chair and the Ranking Member and thank you, Dr. Elmendorf. I appreciate your being here today.

I wanted to ask you, yesterday the administration announced another delay in the implementation of the Affordable Care Act for the business community. Businesses with 50 to 99 employees were given an additional year to comply with the law, and businesses with 100 or more employees are now able to phase in their compliance with the law.

Is this something you have looked at? And has the CBO had an opportunity to review this most recent change and budgetary impact? And do you think it will have a difference? I mean, in your report, you basically, I think, put off some of the conclusions based on the original data of the employer mandate going in in 2015 in terms of what the impact will be on, for example, part-time employment, other employment issues. Where do we stand with all of these changes made essentially unilaterally by Executive order to this law in terms of CBO's analysis on the overall impact on the workforce?

Mr. ELMENDORF. So the analysis in this report, the reports we released last week, both in terms of the budgetary effects and the economic effects of the Affordable Care Act, are based on our view of how the Affordable Care Act would unfold as of early December. So these analyses we do are very complicated, and we need to stop taking on board changes in what is happening and focus on the analysis in order to get these reports done. We are already at work on our next baseline projections. Every year, as you know, we do projections in the spring that are the basis for our cost estimates for the rest of the year. So we are already working to update our projections for the Affordable Care Act and other aspects of the budget.

Yesterday's announcement was, of course, as much a surprise to us as you. These things are complicated, so people have started to look at it. But we have reached no conclusions yet. But our spring baseline projections will incorporate the effects of all of the changes in policy that we can get in as well as all that we learn about what is happening in the insurance exchanges and in Medicaid programs in different States and so on. That is why we labeled these updates that we released last week as, quote, both partial and preliminary.

Senator AYOTTE. Well, at the rate the administration is changing this law unilaterally, I think your people are going to have to be working overtime, because it seems like it is a moving target. So I think this could be a real challenge for you.

Mr. ELMENDORF. I assure you, Senator, the people who work in health care are working over time.

Senator AYOTTE. I bet they are. I can only imagine.

I wanted to ask you about the issue that Senator Toomey asked you on the conclusion in the report about the reduction essentially in the labor participation rate that you have predicted as a result of the Affordable Care Act. Are you concerned at all when you look at this reduction in the labor force in terms of the impact on the subsidies that will cause some people to either leave the workforce or work less hours, as I understand your report? Did I understand it correctly?

Mr. ELMENDORF. Yes, that is right.

Senator AYOTTE. Okay. Who will that have a more disproportionate effect on—lower-wage workers or higher-wage workers?

Mr. ELMENDORF. The change in the labor supply will be primarily by lower-wage workers because they are the people who are facing the largest change in incentives under the Affordable Care Act.

Senator AYOTTE. So are you worried at all that the incentives could have discouragement also on upward mobility? Because if there is a relationship between the amount of subsidy that you receive and whether or not you will continue working or perhaps seek higher employment, could that become a discouragement to upward mobility? In other words, do I take that promotion or don't I for lower-wage workers? We want to encourage more upward mobility.

Mr. ELMENDORF. Yes, Senator. I think the provisions in the Affordable Care Act that we studied reduced the incentive to provide more labor, and that can be reducing the incentive to work more hours or reducing the incentive to work harder in those hours or to do other things that would advance one's labor earnings.

Senator AYOTTE. So is it fair to say one of the concerns we should be keeping an eye on here is that the structure of the law could reduce some incentives for upward mobility—in other words, people seeking to go sort of up higher in the workforce depending on how—based on the structures of the subsidies? That is what I am trying to understand.

Mr. ELMENDORF. So I think, Senator, that the particular provisions that I have talked would, as you are suggesting, reduce upward mobility in that way, but I want to be very careful not to make that conclusion for the Affordable Care Act as a whole because we have not done that particular analysis. And the provision of subsidized health insurance to lower-income people may also affect their upward mobility, and we simply have not analyzed that. So I think these particular provisions that we are talking about that reduce the amount of labor supply do reduce the incentive for people to move up the earnings ladder. But I do not want to suggest that we have drawn that conclusion for the Affordable Care Act as a whole, because other aspects of the provisions could have different effects, and we have not studied—

Senator AYOTTE. No, and I understand, and I would not ask you to draw it as a whole because we do not really know yet, with the changing landscape, with the Executive orders, exactly when things will be implemented on the whole. So I can understand why you would want to qualify your answer. I appreciate it.

Mr. ELMENDORF. Thank you, Senator.

Senator AYOTTE. Thank you.

Chairman MURRAY. Senator King.

Senator KING. Thank you.

Dr. Elmendorf, first I would like to say you are the indispensable man around here. I admire you, and I admire you even more today watching you. You remind me of the guy walking on the tightrope across the Grand Canyon between the various questions, and I think you are doing it very well, and you are providing a tremendous service to us.

One technical question, then some more larger ones. What is the lag time in terms of the increase in interest rates and effects on interest charges? In other words, if all of our debt today was locked in 10 years at 2 percent, an interest rate change next year would have no effect, as I see it, and I am just trying to understand what components of the debt are locked in and what are short term? Because I am concerned about this interest rate increase and the impact on the budget and the crowding out of other priorities, but there is a time lag thing here, isn't there?

Mr. ELMENDORF. Yes, there is, Senator. In our estimates of the effect on the budget of having interest rates that are 1 percentage point higher throughout the coming decade, we take explicit account of the phenomenon you are describing, which is that the Government will sell some new debt next year, and that will incur the higher interest rates right away. Other debt it will not roll over for 8, 9, 10 years, and some debt will not mature at all within the 10-year budget window.

Senator KING. So it would not be accurate to take $17 trillion and say if interest rates go up next week 1 percent, then 1 percent of $17 trillion, that is not the way—

Mr. ELMENDORF. That does not work. What we publish in this appendix to the outlook is itself a rule of thumb for you and your colleagues to use, but that rule of thumb takes account of the phenomenon you are describing.

Senator KING. Thank you. And I perhaps want to follow up on that to get the data.

Mr. ELMENDORF. We are happy to talk to you, Senator.

Senator KING. All this talk about the effect of the Affordable Care Act on people's employment decisions, I believe that in the long run probably the most lasting and important effect of the Affordable Care Act will be the very subject we have talked about, which is the virtual elimination or certainly the significant reduction of job lock, because it is going to free people to start new businesses. That is where the dynamism comes in the country. And I know people and I am sure everyone in this room knows people who said, “I have a great idea, but I cannot leave my job because I have a sick child and I cannot lose my insurance.”

So, you know, this idea that somehow we are discouraging people from work, we are actually liberating people to follow the American principle of self-determination and creativity and innovation. And I think that is a hidden benefit, frankly, of the Affordable Care Act that I am not sure people really calculate. I realize that is hard to calculate in economic terms, but I believe that that is going to be very significant.

The idea that somehow the Affordable Care Act by taking away the linkage between employment and health insurance is something we should discourage, we want everyone to work, you know, pensions, Social Security, why not have everybody work until they are 100? I mean, that just does not make sense to me. We want people working because they need to, they want to, they want to provide for their families, and they want to be creative about it.

A specific question to get to my—another question is: Are tax expenditures expenditures just like Head Start or Pell grants?

Mr. ELMENDORF. As you know, Senator, they are recorded in different ways in the budget, but there is a widespread consensus among analysts that tax expenditures have very similar sorts of effects to direct Federal spending and, thus, should be viewed similarly to direct Federal spending by both analysts and policymakers.

Senator KING. And I would comment to my colleagues from page 89 on in the report a very good analysis of tax expenditures, and really you say they are almost like entitlements because if you are legally qualified, you get them, and they are not examined very often, and they just go on forever. Correct?

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

Senator KING. It just strikes me that we are talking around here about how we pay for things, and it is always it is okay to pay for it by taking away some benefit that the disabled get or somebody else, but to say you cannot look at tax expenditures because that is revenues is really a misunderstanding of the fact that the two are really virtually identical.

Mr. ELMENDORF. I want to mention, Senator, we issued a report last year that looked in a more in-depth way at tax expenditures, including at the distribution of tax expenditures, also at their economic effects, and people who are interested in that topic, we are happy to send you that report.

Senator KING. I have not seen that report, but I am guessing that tax expenditures tend to go more heavily to people with higher incomes.

Mr. ELMENDORF. Well, different expenditures are quite different, so the earned income tax credit induces some tax expenditures that are obviously toward the lower end of the income distribution. But the State and local income tax deduction tends to be more for the high end of the distribution. So we will make sure you have that on your desk today, Senator.

Senator KING. Fine. I will have one more question for the record, but a final question is: Not fixing infrastructure is debt, is it not?

Mr. ELMENDORF. Well, it is a different sort of future commitment.

Senator KING. But it has to be paid eventually.

Mr. ELMENDORF. If we think we will ultimately repair the bridge or expand the highway, then not doing it now, putting it off, is putting a burden on the future in a way that is similar to the burden of doing something and borrowing to pay for it.

Senator KING. Carefully parsed, but I would take your answer as a yes.

Mr. ELMENDORF. Senator, I would like to close by noting that although you kindly referred to me as indispensable, as you and your colleagues understand, it is my colleagues who are indispensable. And if I have good answers for your questions, it is because of the things they have taught me. But they also taught me to be careful in how I put things.

[Laughter.]

Senator KING. And I will bet after last week you certainly understand that. Thank you, sir.

[Laughter.]

Chairman MURRAY. Senator Portman.

Senator PORTMAN. Thank you, Madam Chair.

Dr. Elmendorf, thank you for your indispensable staff and you and your personal responsiveness to our questions and your input and for being here today. I have so much I want to ask you about and so little time, so I am going to go quickly here. I want to focus on three things:

One, of course, is what the real problem is in the deficit, and I think your new report only emphasizes what we already knew.

Second is, What can we do on growth?

And then third is, What is the impact of Obamacare on growth?

In terms of the deficits, this was a discouraging report for me because it shows things are getting even worse. If you could give me just a series of quick yes-or-no answers, that would be great.

Am I correct that in the past 50 years Federal revenues have averaged just under 18 percent of GDP?

Mr. ELMENDORF. Senator, we have averages for 40 years, and we say it has been about 17.5 percent.

Senator PORTMAN. Less than 18 percent over the last 40 years. Over the next decade, you projected that it would average more than 18 percent of GDP. Is that right?

Mr. ELMENDORF. Yes.

Senator PORTMAN. And you are saying it will keep rising thereafter?

Mr. ELMENDORF. Under current law, yes.

Senator PORTMAN. Okay. So the notion earlier we talked about, you know, that we need more revenue, we are above the historic average based on your projections over the next 10 years and continuing to grow.

How about discretionary spending and what we call other mandatory spending? Are those falling as a percent of the economy over the long term?

Mr. ELMENDORF. Yes, under current law, Senator, and the projection—

Senator PORTMAN. Okay. So what is left? Discretionary spending is what we appropriate here every year; "other mandatory" is part of the two-thirds of the budget that is mandatory. Social Security, health entitlements, 7.8 percent of GDP in 2005, now 9.7 percent of GDP, on their way to 13.7 percent of GDP in the next 20 years. Is that correct?

Mr. ELMENDORF. That sounds right, Senator.

Senator PORTMAN. And you project that health entitlements alone are going to go up over 100 percent, more than double, 115 percent in the next 10 years now. Is that right?

Mr. ELMENDORF. The spending for the major health care programs we project to rise from 4.8 percent of GDP this year to 6.1 percent in 2024. If you are referring—

Senator PORTMAN. In nominal terms—

Mr. ELMENDORF. —to a nominal—

Senator PORTMAN. In nominal terms, you go 115 percent over the next 10 years.

Mr. ELMENDORF. I take your word for it, Senator.

Senator PORTMAN. Okay. Steeply rising national debt and its resulting interest costs are mostly the result of what, borrowing for what specific programs?

Mr. ELMENDORF. Well, the borrowing is for the gap between spending and revenues, as you know, Senator.

Senator PORTMAN. Right, but—

Mr. ELMENDORF. But the part of the budget which is—

Senator PORTMAN. We just talked about the fact that—

Mr. ELMENDORF. —growing most substantially is spending for Social Security and the major health care programs.

Senator PORTMAN. Okay. So we have identified what the focus ought to be. We are heading toward record high tax revenues over the decade, nearly record low discretionary spending, falling other mandatory spending, so we are talking about these important programs but unsustainable in their current form, health care entitlements, Social Security, and the resulting net interest cost. Is that correct?

Mr. ELMENDORF. There is a striking shift in the composition of Government spending toward those few large programs you have highlighted, Senator, yes, and away from other things.

Senator PORTMAN. So the next question is, How do you solve that? Obviously we need reforms, again, incredibly important programs. But we have heard a lot about a balanced solution which basically is to make the next generation pay the cost for our generation as opposed to reforming these programs. So that is very clear in your report. This is the problem. We have to address it. And if we do not, we will face consequences you talked earlier, including the possibility of a fiscal crisis.

Second, the economy. I found it depressing, actually, what you put on your report. I am not saying you are wrong. I am saying that you are asking us to accept a new normal, and that new normal is not for 5 percent growth. It is 2 percent growth. In fact, what you tell us is that in this new baseline you have pared back your economic growth assumptions, which, by the way, have always been more optimistic than what actually happened in the last several years, and so I understand why you did it, 2.5 percent over the next decade, decelerating to just 2 percent in 2024; $1.4 trillion less tax revenue, therefore, over the next decade. And, you know, this is not the first time this has happened. Since, again, President Obama took office, you have consistently come out with decreases in projected economic growth. Those have translated just in this President's term to more than $2.2 trillion in reduced tax revenue when you take those projections out to 2024. And, remember, this is all about the bad economy since the President took office.

So earlier you talked about this, but economic growth obviously is key. Restraining the spending, the growth, we need it. Economic growth through tax reform, would that make sense, lowering the rate and broadening the base?

Mr. ELMENDORF. That would be good for the economy, Senator, but—

Senator PORTMAN. How about trade?

Mr. ELMENDORF. It depends on the specifics of the reform.

Senator PORTMAN. Would trade be good for the economy, expanding trade?

Mr. ELMENDORF. Yes, it probably would be, Senator, again—

Senator PORTMAN. Okay. Trade promotion authority is before us right now. How about long-term debt reduction through these reforms we have talked about?

Mr. ELMENDORF. That would be good for the economy in the—

Senator PORTMAN. That would be good for the economy, so it is three—

Mr. ELMENDORF. —long term, Senator.

Senator PORTMAN. —things. How about more domestic energy production?

Mr. ELMENDORF. I think that would be good for the economy as well, and—

Senator PORTMAN. This is what is frustrating, is we have these things that you know would work and we know would work, and if we would just do them, we could both deal with the spending side and the growth side.

On Obamacare just quickly, I appreciate you looked at the work of Casey Mulligan and others at the University of Chicago. There has been a lot of talk about this today. People are leaving the workforce because of this sharp cliff. I would say to my colleagues on the other side who said, you know, this is all about moms who want to stay home with their kids and it is all about people starting new businesses or even working in their family businesses. I mean, if you are working, you are working, and you are not out of the workforce, first. But tell us the demographics of this group that is likely to drop out. What do you know about them?

Mr. ELMENDORF. The attributes of the group?

Senator PORTMAN. Yes.

Mr. ELMENDORF. So the biggest effects, as we wrote, Senator, are primarily on people of lower income because they are the ones who are receiving the subsidies through the Affordable Care Act. It is the existence of the subsidies and the withdrawal as people's income rises that create—that reduces the incentive to work.

Senator PORTMAN. So as Mulligan says, about a 50 percent, in effect, tax or penalty on work because of this cliff. But tell us who these folks are. Do you think it is primarily people who would like to retire early or moms who want to stay home with their kids? Who is it? And I ask you this because when you look at the labor participation rate, which is already at 1970s levels, it is a record low for men right now. It is a record low for working men. And here we are taking this labor participation rate even lower, fewer people working, which is bad for the economy, it is bad growth, it is bad for prosperity. When you look at this data that we know out there—and the early indications are this tends to be single men, they tend to be childless. And my concern is we are going to even exacerbate further this already record level. What do you think about that?

Mr. ELMENDORF. So, Senator, the subsidies under the Affordable Care Act affect a broad range of types of people, and we did not do this analysis in a way that lets us isolate the effects on particular—

Senator PORTMAN. Could you look at the Brookings study on that and look at whatever else you think is appropriate and get back to me on that as to who you think really is going to be affected here? We talked about the fact that these are people who you want to get on that ladder of opportunity, that income ladder and moving up on the ladder, and this takes them off the ladder, reduces their Social Security benefits, as you know, because their lifetime earnings are going to be reduced. It takes them out of this possibility of being able to achieve their dream for themselves and their families because they lose, again, the dignity and self-respect and the opportunity that comes with work. And that is my concern, is that—I know you and I disagree on some of the Obamacare impacts on the labor demand side. I think that $1 trillion in new taxes does have an effect on workers. I think also the 50-person limit and the part-time at 30 hours does have an effect. We may disagree on some of that. But this data is really concerning because it exacerbates an already terrible problem we have, and you do not have to do it. You can solve these health care problems without that stiff cliff. And that is one of the differences maybe between the two sides here, is that there are ways to do it, including through the Tax Code, that have been talked about where you would not have that 50-percent penalty and still be able to address many of the problems on pre-existing conditions and other issues that have been raised today.

I am over my time. Thank you, Madam Chair, for your indulgence. Thank you, Dr. Elmendorf.

Mr. ELMENDORF. Thank you, Senator.

Chairman MURRAY. Senator Coons.

Senator COONS. Thank you, Senator Murray, and thank you, Director Elmendorf, for your work and for the work of your team and for the very valuable report you have delivered. I am struck at how across all the questions from members of this Committee, the one North Star is economic growth. We have talked back and forth about this Grand Canyon that Senator King suggested you are trying to navigate across the tightrope. The other side wants to focus almost exclusively on entitlement reform. We want to talk about tax expenditures. We think extending unemployment insurance will be stimulative for the economy. They think reducing regulatory burden—we seem to go back and forth on these issues with great predictability.

One thing that I wanted to ask for your input on was the one area where I hear general agreement between our parties, and that is in manufacturing. Restoring robust economic growth in the United States strikes me as one of the best ways to achieve deficit reduction and to achieve return to full employment and to achieve a lot of other shared objectives.

There are about 25 of my colleagues and more than a dozen bipartisan bills that would strengthen significantly the environment, the ground for manufacturing, and for the continuing growth in manufacturing employment in the United States. Manufacturing jobs, as you know, are among the highest-quality jobs, have the best multiplier effect, and they have the best impact on their immediate community. And the bills broadly speak to skills, access to credit, investment in R&D, export markets, infrastructure.

Could you just comment on the relative importance of manufacturing as a sector to contributing to growth and what you see as appropriate policy actions we might take on a bipartisan basis that would strengthen that sector?

Mr. ELMENDORF. Senator, those are hard questions for which I do not have adequate answers. You are certainly correct that manufacturing jobs have tended in the past to provide higher-than-average wages and better than average benefits. But we have not done an analysis ourselves, at least at my time at CBO or that I am aware of, of what policy actions might do for the manufacturing sector and how that might then ripple through the broader economy.

So, again, you ask questions to which I wish had answers, but I do not have them, I am afraid.

Senator COONS. Well, I would be eager to work with you, if I possibly could, at submitting for some review and discussion a variety of both historical and prospective policy tools that have been brought to me and to many of my colleagues by the manufacturing sector, by manufacturing leaders in my State and the country around skills, credit, export, R&D. It is an area where Government action and fiscal policy can make a significant, enduring difference.

Let me turn to one other topic in my time here, which is interest rates, and a number of other Senators have asked about this. There are, I think, roughly half of our current debt held by foreigners, and they have difficulty, I think, sometimes discerning the dance of politics here in the Capitol. I would be interested in what you view as the short-term and long-term threats to our interest rate, to our debt service costs. We have in recent years had, in my view, far too many close calls where there was open discussion of the possibility of default, and I think that has increased our borrowing costs. And then there are long-term drivers that also create some question about the debt service costs that we may face going forward. So if you would just briefly speak to the short-term and long-term drivers, I would be grateful.

Mr. ELMENDORF. So, Senator, we think that defaulting on any obligation of the U.S. Government would be a dangerous gamble, and that is importantly because, until now, investors had been able to count on the Federal Government paying its debt. And if that were to change, it would have consequences that could be very severe, but that are hard to quantify given the lack of historical experience.

Interest rates can go up or down for a variety of reasons, and some would be good things for the economy as a whole, but would make the Government's interest burden larger and some—for example, if there were much stronger economic growth than we expect over the next few years, that could increase private credit demands and push up interest rates in a way that would basically make this Committee and other people happy about the economy but could raise the cost of Government borrowing. If the economy is weaker in the next several years than we expect, that could keep interest rates lower.

So there are economic factors that will matter, but also the perceived risk of Treasury securities and the perceived risk of other investments. As you know, capital can come into the U.S. Treasury market if it is leaving other financial markets that seem more dangerous. There is a wide panoply of factors that can affect interest rates, but—although one might root for low interest rates for the Federal Government, of course, that might come together with a weak economy, which is exactly what you are not rooting for. So one does not want to think about high or low interest rates as necessarily correlating with good or bad economic circumstances in general. And we look at a variety of forces that can affect interest rates. In our projections we think we balance the risks. But the risk of rates being a good deal higher or lower than we thought is a very real one.

Senator COONS. But to be clear, if I understood your testimony, publicly discussing the possibility of default, urging default as a negotiating tool in policy debates is—and I think I am quoting you—a "dangerous gamble."

Mr. ELMENDORF. Yes, Senator.

Senator COONS. Thank you.

Thank you, Chairman.

Chairman MURRAY. Thank you very much. I want to thank all of our colleagues who participated today. Dr. Elmendorf, I especially want to thank you and, again, this Committee really does appreciate all the hard work that you and all of your staff put in in order for us to do our work, so thank you very much for being here.

As a reminder to all of our colleagues, if you have any additional statements or questions, they need to be submitted by 6:00 p.m. today.

Senator SESSIONS. Madam Chair, just briefly, it looks like the President's budget will be late again. There are some reasons for that. Director Burwell called to discuss that.

Chairman MURRAY. She has been very clear that there has been—we were late, they are late.

Senator SESSIONS. But that result is causing us a problem I will write you about. Fundamentally, by the time she testifies, we still will not have had the complete budget. I think that would be better. So if there is some way we could alter the course we are on so that we do have the President's complete budget when she testifies, I think that would be essential for our smooth operation.

Chairman MURRAY. I would be happy to discuss that with you.

Senator SESSIONS. Thank you, Dr. Elmendorf.

Chairman MURRAY. Thank you.

Mr. ELMENDORF. Thank you very much.

[Whereupon, at 12:19 p.m., the Committee was adjourned.]

# THE ECONOMIC AND BUDGET OUTLOOK FOR INDIVIDUALS, FAMILIES, AND COMMUNITIES

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**TUESDAY, FEBRUARY 25, 2014**

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
*Washington, D.C.*

The Committee met, pursuant to notice, at 10:35 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Stabenow, Whitehouse, Sessions, and Johnson.

Staff Present: Evan T. Schatz, Majority Staff Director; and Eric M. Ueland, Minority Staff Director.

### OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. The hearing will come to order.

I want to welcome everyone and thank my Ranking Member Sessions and all of our colleagues who are joining us this morning. And I want to extend a very special thank you to all of our witnesses for being here today: Edith Kimball, Courtney Johnson, Neera Tanden, Robert Doar, and Scott Winship. Thank you all for being here. And, Edith, I understand this is one of the rare times in your life you

have seen snow, so welcome to Washington, D.C.

[Laughter.]

Chairman MURRAY. Because of the votes that are now scheduled starting at 11:15, I am going to be very brief in my remarks. I want to make sure we have enough time to hear from all of our witnesses.

At our last Committee hearing with Dr. Doug Elmendorf, we examined the economic outlook from the macro level, but to me it is just as important that this Committee also examines the micro level. I want to hear from people across the country about how the Federal budget affects them—people like Edith Kimball, from Lee, Florida, mother of three, who works as a food service professional at her children's elementary school. Courtney Johnson joins us from Columbus, Ohio. She is a high school English teacher and has a son in the second grade. I hope their stories today will serve as a reminder to all of us that we have work to do to expand opportunities for more Americans.

The simple truth is, across the country, too many people sit at their kitchen table, wondering how they are going to be able to pay this month's bills or save enough to send their kids to college.

Those challenges leave people without the opportunities they need to get ahead.

I am hopeful that Congress will build on the bipartisan progress that we have seen in the past few months. As we all know, late last year, Chairman Paul Ryan and I compromised to reach a 2-year budget agreement, and that compromise was a strong step in the right direction. And I now hope we can work together to create more opportunities for people and families and do that by investing in education and job training and manufacturing so more Americans can climb the economic ladder.

Expanding opportunity is not just the right thing to do; it is good for our economy. And it is a good solution for our long-term fiscal challenges.

So I hope we can work together on a bipartisan basis to create jobs, grow the economy, invest in our middle class, and expand opportunity for more Americans. And I am looking forward to hearing from all of our witnesses today after I turn to my Ranking Member, Senator Sessions, for his opening remarks.

## OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you, Madam Chairman.

CBO Director Elmendorf recently testified before this Committee to share an alarming diagnosis. He declared our current debt trajectory to be unsustainable and "raises the risk of a fiscal crisis." The last thing we need is another fiscal crisis.

One of the clearest indicators of the danger we face is the rising interest we pay. Our debt today stands at $17 trillion, and we owe $233 billion, he projects, in interest this year on that debt. In 10 years, he projects continued—the debt and interest will grow to a mind-boggling $880 billion in 1 year annual interest payment. This is money for which we get nothing. It will crowd out spending on all kinds of investments that the Chair would like for us to make.

So I was, therefore, stunned to read, according to the Washington Post, that the White House has declared the President's 2015 budget will mark "an end to the era of austerity." Our debt has grown 67 percent in the past 5 years, and we have had annual four deficits over $1 trillion. As Charles Krauthammer said such a characterization is "an assault on the dictionary."

The Washington Post also reported that the President plans to bust the budget caps in Ryan-Murray that he signed into law only 8 weeks ago. The ink is not even dry, and he is already proposing we bust the new and higher spending caps that were passed. Do promises mean nothing in this country anymore?

So I hope our distinguished Chair will join me in opposing any plan from the President that would spend more than we agreed to spend under Ryan-Murray.

I am looking forward to our conversation today. The American workers are hurting. Wages are down. The workforce is shrinking. Welfare rolls continue to grow. We have a moral duty to take firm, principled steps that will actually help millions of struggling workers transition from joblessness and dependency to work and rising wages.

Clearly this goal cannot be accomplished simply by borrowing and spending more money. There is an article in yesterday's paper that said, "CBO reports stimulus now taking its toll. Economy will soon be worse off than if the stimulus law had never passed."

Mr. Elmendorf told us that would be the case. The sugar high is over. We will pay the interest and bear the burden of that stimulus plan, every penny of which was borrowed, for decades to come.

So over the last 5 years, we have added a staggering $7 trillion in debt. So what do we have to show for this? Just ask this honest question. Has it worked? Twenty-nine million people are unemployed or have become discouraged from even seeking a job. Nearly one in two college graduates are underemployed. We have 800,000 fewer jobs since the recession began, but the population has grown by 15 million. The share of the population actually working has declined to the lowest level in 40 years. Wages for American workers are lower today than in 1999. Take-home pay has fallen each of the last 5 years. Forty-seven million people are on food stamps.

So the desperate need today is for growth and job creation and higher wages. We can all agree on that. But what action do our Democrat colleagues propose to fix this problem? Energy restrictions, more restrictions on energy that drive up costs and destroy jobs; unprecedented increases in Federal regulations that are hurting our factories and small businesses; a health care law that the CBO confirms will result in the loss of another 2.5 million workers; higher taxes that enrich a booming Washington, the only place in America that's booming really other than North Dakota is here in Washington, while our middle class is being impoverished; a weak trade stance that allows China to devaluate its currency and foreign competitors to game the system, sending our jobs abroad; an immigration plan that would double the flow of immigrant workers, by definition job takers, competing against unemployed Americans by the millions; a new minimum wage that will reduce the number of jobs by 500,000 to a million, according to Mr. Elmendorf; a budget plan that will never balance and would add trillions to the long-term debt, resulting in weaker growth and a diminished future for our children.

So we cannot keep hurting the future, burdening the future, to enjoy a sugar high today. So we should work on a strategy that would reduce our welfare rolls and bring our workers to prosperity.

And I will just put the rest of my remarks in the record and say one more point. To me, it is so important that we use the welfare office as a job training office, an office to advance people from dependency to independence, to have, Madam Chair, like the special ed, an individual IEP right, individual education plan. We need an individual employment plan for each person that is hurting, unemployed, and help move them out into employment. We can pay for that by reduced welfare and improved economic growth in our economy.

So I feel strongly that we are not doing well in America today. We can do better. And I think there is, unfortunately, some disagreement about how to get there.

So I thank the Chair and look forward to this excellent panel.

[The prepared statement of Senator Sessions follows:]

**Senator Jeff Sessions Opening Statement**

CBO Director Douglas Elmendorf recently testified before this committee to share an alarming diagnosis of our fiscal path. Dr. Elmendorf declared our current debt trajectory to be unsustainable and "raises the risk of a fiscal crisis." One of the clearest indicators of the danger we face is the extraordinary and rising interest that we owe on our massive federal debt.

Our debt today stands at more than $17 trillion and we will owe $233 billion in interest on that debt this year. In 10 years, as the debt continues to grow, we will owe a mind-boggling $880 billion in interest payments in a single year. This is money for which we get <u>nothing</u>. Interest is the fastest-growing item in our budget, and it crowds out other spending on valuable projects.

I was therefore stunned to read that, according to the *Washington Post*, the White House has declared the President's 2015 budget will mark "an end to the era of austerity." Our debt has grown 67 percent in the last five years, and we've had four deficits above $1 trillion. As Charles Krauthammer said, such a characterization is an "assault on the dictionary."

The *Washington Post* report also indicates that the President plans to bust the budget caps in Ryan-Murray that he signed into law only eight weeks ago. This is unbelievable. The ink isn't even dry and he's already proposing that we bust the new, higher spending caps. Do promises mean nothing?

I hope our distinguished Chairwoman will join me in opposing any plan from the President that spends more than we agreed to spend under Ryan-Murray.

We have a moral duty to take firm, principled steps that will actually help millions of struggling workers transition from joblessness and dependency to work and rising wages.

American workers are hurting. Wages are down, the workforce is shrinking, and the welfare rolls continue to grow.

Clearly, borrowing and spending more money is not the answer. Over the last five years, we've added a staggering $7 trillion to the debt. And what do we have to show for it?

- 20 million people are unemployed, underemployed, or have been discouraged from looking for jobs
- Nearly 1 in 2 recent college graduates is underemployed
- We have 800,000 fewer jobs since the recession began but the population has grown by more than 15 million
- The share of the population that is actually working has declined to its lowest level in nearly 40 years
- Wages for American workers are lower today than they were in 1999
- Total take-home pay has fallen each of the last five years

- 47.6 million people are now on food stamps

So the desperate need is for growth and job creation and higher wages. But what action is proposed by President Obama and Congressional Democrats? Let's list them:

- Energy restrictions that will drive up costs for consumers and destroy good-paying jobs
- Unprecedented increases in federal regulations that make it harder for our factories to compete
- A health care law that the Congressional Budget Office confirms will result in the loss of another 2.5 million full-time workers over the next decade. That translates to more than a trillion dollars in lost personal income.
- Higher taxes that enrich a booming Washington D.C. while impoverishing our beleaguered middle class
- A weak trade stance that allows China to devalue its currency and foreign competitors to game the system, sending our jobs and wealth overseas
- An immigration plan that would double the flow of immigrant workers competing against unemployed Americans
- A new minimum wage that will reduce the number of available jobs by between 500,000 and 1 million
- A budget plan that would never balance, would add trillions to our long-term debt, and would result in weaker growth and a diminished future for our children

We can't keep hurting our future to enjoy a sugar high today. A dramatic new strategy is needed. The centerpiece of the strategy should be a consuming national effort to reduce the welfare rolls and grow the employment rolls.

Currently, the federal government spends around $750 billion a year on means-tested welfare and poverty support. That's more than Medicare, more than Social Security and more than Defense.

Imagine how much could we could do if we redirected this spending to focus on job training, job placing, and work preparation. Wouldn't that be a better, more productive, and more compassionate plan? One that would work?

Every Senate Democrat voted for an immigration bill that was said to be needed to fill jobs Americans are unqualified to take. Would it not be better to transition those hurting Americans now on welfare into open jobs, rather than bringing in more new workers from abroad?

We need a welfare-to-work program, not a doubling of guest workers. And it can be more than paid for with welfare savings.

Across the board, we need to reorient all of our policies in Washington towards helping the economy grow and getting Americans back to work and out of poverty. We cannot do this by expanding government—just look at the dramatic negatives consequences from Obamacare. And we can't do it by borrowing more money. Instead, we must take steps that create growth and more good-paying jobs, at better wages, in the private sector. Here's how:

- More American energy that creates good-paying jobs right here in the U.S. This also makes our manufacturing more competitive and it lowers energy and gasoline prices for all.
- A streamlined tax code allows U.S. companies to grow and U.S. workers to compete on a level global playing field
- Eliminate every unnecessary regulation that destroys jobs and closes factories and small businesses
- Saving American jobs and wages by repealing Obamacare—a huge job-killer
- A trade policy that increases U.S. exports, expands domestic manufacturing, and insists on fairness from our trading partners
- An immigration policy that serves the interests of the American people
- Converting the welfare office into a job training center
- Making government leaner and more efficient—doing more with less
- Restoring economic confidence by reducing spending and balancing the federal budget

All of these steps, every one of them, will create jobs and help grow the middle class—instead of growing Washington. All of these policies will strengthen, not imperil, our children's future. None add to the debt.

No longer can we measure compassion by how much we spend on poverty. Instead, we must measure compassion by how many people we lift out of poverty. The economic agenda of the Left has failed struggling communities for generations; it will never work. It is long past time for a new approach.

And we will hear some ideas for a new approach today. I'd like to introduce Robert Doar and Scott Winship.

Robert is the Former Commissioner of New York City's Human Resources Administration and the Morgridge Fellow in Poverty Studies at the American Enterprise Institute. Robert spent 7 years as the Commissioner in New York City, where he was responsible for administering 12 public assistance programs including Medicaid and Food Stamps. Before heading to NYC, Robert was New York State Commissioner of Social Services where he developed a renowned reputation for knowing what works and what doesn't as well as how to help struggling families.

Scott is the Walter B. Wriston Fellow at the Manhattan Institute, where he studies economic mobility and inequality. Scott has become highly regarded in Washington as a creative scholar with innovative ideas on how to promote upward mobility to those growing up in the poorest of communities. Scott is also one of the most honest brokers of the data on poverty and mobility.

I look forward to hearing from them and from all of our witnesses.

ECONOMY

# CBO: Stimulus now taking its toll

## Economy will soon be worse off than if law never passed

BY STEPHEN DINAN
THE WASHINGTON TIMES

President Obama's stimulus may have boosted the economy when it passed in 2009, but it's now beginning to take a toll and will soon begin to leave the economy worse off than if it had never passed, according to a new report from the Congressional Budget Office.

Mr. Obama signed the stimulus into law five years ago last week, vowing it would help rescue the economy from its post-Wall Street collapse tailspin, and saying it would save millions of jobs.

The CBO said it's been successful at that, helping sustain between 700,000 and 3.6 million jobs at its peak in 2010. But the scorekeepers had always warned that borrowing all of that money would eventually catch up with the economy and, over the long run, leave it slightly worse-off than if no stimulus had ever passed, and that is about to come true.

"In contrast to its positive near-term macroeconomic effects, ARRA will reduce output slightly in the long run, CBO estimates — by between zero and 0.2 percent after 2016," the analysts said in their new report.

They said the cause is all of the borrowing for the $830 billion program, which dramatically boosted the federal debt.


ASSOCIATED PRESS

President Barack Obama's stimulus may have boosted the economy when it passed in 2009, but now its taking its toll.

"To the extent that people hold their wealth in government securities rather than in a form that can be used to finance private investment, the increased debt tends to reduce the stock of productive private capital. In the long run, each dollar of additional debt crowds out about a third of a dollar's worth of private domestic capital," the CBO estimated.

Just as striking, more than $40 billion of the stimulus remained unspent as of the end of 2013, the CBO said.

The stimulus was initially projected to cost $787 billion over a 10-year period, but the CBO now puts the price tag at $830 billion.

The money that did go out in 2013 supported between 100,000 and 500,000 jobs and held the unemployment rate down by as much as three-tenths of a percentage point, the analysts calculated, based on economic modeling of government spending and taxes.

The findings come on top of several other CBO reports that found Obamacare and a minimum wage hike of the magnitude being pushed by Democrats would both leave the job market rougher in a few years.

In terms of Obamacare, the CBO said that the subsidies and other government incentives included in the massive health overhaul will entice more people to quit jobs, figuring they can end up ahead by taking government benefits instead. That will cause the equivalent of about 2 million people to drop out of the workforce by 2017, the agency said.

As for the minimum wage, the CBO said hiking it to $10.10 per hour by 2016 will cause employers to shed about 500,000 jobs that year.

Chairman MURRAY. All right. Thank you very much, and, again, thank you to all of our panelists for being here today.

We are going to start on my left, Ms. Kimball, with you, and work our way across. So we will start with you. Thank you.

**STATEMENT OF EDITH KIMBALL, FOOD SERVICES PROFESSIONAL, LEE ELEMENTARY SCHOOL, LEE, FLORIDA**

Ms. KIMBALL. My name is Edith Kimball, and I thank you for inviting me to be here today. I have been married to my husband, Kenny, for 14 years. We have three children: 9-year-old twins, a boy named Cameron and a girl named Olivia; and a 7-year-old, Jacob. I have lived my entire life in my small town of Lee, Florida, where I have worked as a food service professional at Lee Elementary for the past 3 years.

Lee is a rural town in Madison County between Tallahassee and Jacksonville and near the Florida-Georgia State line. It is a caring community where you know just about everybody and people are willing to help out and lend a hand when someone is in need. We have a saying in Lee: "Little, But Proud."

Our county is one the poorest in the State, and jobs have been tough to come by. About 20 years ago, a meat-packing plant closed down. It was a place where hard work was rewarded; you could move up the ladder and provide for your family. A lot of workers were the second or third generation in their family to work there. When the plant closed its doors, it devastated many families.

I feel blessed to work at our elementary school where I work with my mother, who is the food service manager. Together, we prepare and serve almost 200 meals each day. Lee Elementary is a school full of great, well-mannered kids who say "Yes, ma'am" and "No, ma'am." My school is special because of the caring teachers who pour their hearts into teaching their students. As a parent, I appreciate this.

My school, like our county, is poor. A few years ago almost all our kids were on free or reduced-price lunch, and now a new grant helps provide meals to all of them. I love preparing healthy meals for them, even though many are picky eaters. And I know many of their families, like mine, struggle to make ends meet.

Before the elementary school, I worked for a local grocery store for 10 years. I still remember families would come in with food stamps, and I knew they had to make that food last for their family until the end of the month. After Jacob was born, I chose not to return to the grocery store because of the high cost of child care. It just did not make sense for our budget. And I needed a job that would let me be there for my children after school. My prayers were answered when I got my job at Lee Elementary.

I knew that the pay would not be great, but I would be there for my children, especially my oldest son, who is a special needs child, and be home to help my other two children with their homework to become better students. Being home when my kids are home is important. My husband, Kenny, is a truck driver and is on the road for 4 to 6 weeks at a time.

Kenny is the owner/operator of his truck, which means he pays the maintenance and all costs for it. Between fuel costs, truck payments, and maintenance, there is not a lot left over at the end of the month. We get by decently. We pay our bills, buy groceries, and pay our tithe to our church, but there is no room for extras at the end of the month.

I know that Congress is talking about raising the minimum wage. For me, in my job that would mean an increase of $200 more a month for my family. That would help give us a just a little more in our budget. It could even help me open a college savings plan for my children for their future.

Every parent wants the best for their children, and I am not any different than any other parent. My daughter, Olivia, wants to be a doctor. It is my responsibility to see to it that she gets the best education available. I have told her she will have to study and work hard and I would do my best to see that she could fulfill that dream. But right now that is going to be difficult for my family.

I know other families in my town that would be helped by an increase in the minimum wage, too, and I think it would make more people want to work. It is my prayer that you will think about towns like mine and families like mine when you make major decisions here. We should not be forgotten and left by the wayside.

Thank you to Chairwoman Murray and all of you for the chance to talk to you today.

[The prepared statement of Ms. Kimball follows:]

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**"The Economic and Budget Outlook for Individuals, Families, and Communities"**
**Before the**
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Thank you to Chairwoman Murray and all of you for the chance to talk to you today.

Chairman MURRAY. Thank you very much.
Ms. Johnson, we will turn to you.

## STATEMENT OF COURTNEY JOHNSON, HIGH SCHOOL ENGLISH TEACHER, FORT HAYES ARTS AND ACADEMIC HIGH SCHOOL, COLUMBUS, OHIO

Ms. JOHNSON. Good morning. Thank you, Chairwoman Murray and members of the Committee, for inviting me to speak to you today.

Three years ago, when I came here to Washington, D.C., to talk to Congress about why I as a teacher valued collective bargaining, I would have considered myself solidly in the middle class. Today, like so many others, my family's foothold in the middle class has become perilous.

I am a high school English teacher at a public arts magnet school in Columbus, Ohio. My large urban school district is in financial trouble. State budget cuts, Federal sequester cuts, indirect cuts through charter school and voucher programs, and the end of one-time Race to the Top money means that many good teachers will lose their jobs. I worry that I will be laid off in the coming weeks as my district has to find a way to trim $50 million more from our already bare-bones budget. My husband, who holds a degree in health care administration, was laid off last month. In the past few years, we have made two major moves, suffered two job losses, and had to rely on Brad's 401(k) to stay afloat. We know we are fortunate to have had that money.

But we live under constant anxiety that I will be laid off, that Brad will not find another job, and that we will not be able to sell our home should we need to find more affordable housing. I bring home less in my paycheck now than I did 3 years ago. Our Governor has raised the sales tax, spreading my smaller paychecks thinner and thinner. We cannot even fathom saving for college for our son, Brady, as we are still paying for our three degrees between the two of us. We only had one child because the cost of quality child care was too much. And yet we are fortunate. When I compare my family's situation to my students' families, I know that we are fortunate.

I do not know all the specific policies that have contributed to the decline of the middle class, but I know that when folks do not have good jobs, everything else in our society unravels. When we cannot meet our basic needs of safety and security, we cannot care about much else. As any teacher will tell you, it is about the hierarchy of needs. I care very much about many issues: public education, women's rights, workers' rights, voting rights. But most of all, I care about whether or not we have jobs in my community. If I have to work three low-wage jobs, I do not have time to help my kids learn to read or do their homework. I cannot send my kid to college. I do not have time to be an informed voter. I do not have time to care about anything but paying my bills and making sure my family is fed.

Anti-worker policies like the erosion of collective bargaining, wage stagnation, and free trade agreements have destroyed the middle class that labor built. I just read in the New York Times a couple of weeks ago that the top 40 hedge fund managers make as much as a third of all high school teachers in America combined. Where are we as a country when we do not value and respect the dignity of work?

I am frustrated that the pathways to the middle class that existed for my generation no longer exist for my students or my son. Why does the American dream have to end with me?

When I was a little girl growing up in Ironton, Ohio, I knew that college was how I entered the middle class. Becoming a teacher was not something I settled for as a career. I made a choice. Teaching was my pathway to making a middle-class life that would allow me to build lives, too. Where are we as a country when the folks who teach our children cannot have a stable economic avenue into the middle class?

But that college opportunity that I was privileged to have is not there for many of my students. Just a few weeks ago, I was sitting with a bright young senior as she anxiously scrolled through her college application, and she sat like with, with her head in her hands, and she said, "I just want to go to college." How will she afford it? It is heartbreaking, and I do not have an answer for her. We are complicit in a system where wealth protects wealth, and college is the new lotto ticket. Community college or bust is the story of dreams deferred. We are telling young people, "College is not for you." We are the first generation to break Horace Mann's vision for America. He said, "Education is the great equalizer." Where are we as a country when our young folks have no hope of a pathway out of poverty and into the middle class?

We can create a world where kids can have hope that they can move out of poverty and into a strong middle class. You can work on investing in jobs and ensuring job creation in my State and in my community. You can raise the minimum wage. You can make education the great equalizer by providing formula-based funds to public schools where they are needed the most. You can make college affordable.

I still have hope. My hope is in the eyes of my students and my second grader. They still believe in the promise of America and trust in education as the most powerful tool for advancement. But they cannot act alone. We give our power and our voice to you, our elected officials. Please speak—and act—on our behalf.

Thank you again for inviting me to be here today.

[The prepared statement of Ms. Johnson follows:]

**Testimony of Courtney Johnson,**
**High School Teacher, Columbus, OH**

**"The Economic and Budget Outlook for Individuals, Families, and Communities"**
**Before the**
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Anti-worker policies like the erosion of collective bargaining, wage stagnation, and free trade agreements have destroyed the middle class that labor built. I just read in *The New York Times* a couple of weeks ago that the top 40 hedge fund managers make as much as a third of all high school teachers in America combined.[1] Where are we as a country when we do not value and respect the dignity of work?

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Thank you again for inviting me to be here today.

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1 Krugman, P. (2014, January 29) Hedgies Versus Teachers. *NYTimes.com.* Retrieved February, 21, 2014, http://krugman.blogs.nytimes.com.

Chairman MURRAY. Thank you very much.
Ms. Tanden?

**STATEMENT OF NEERA TANDEN, PRESIDENT, CENTER FOR AMERICAN PROGRESS**

Ms. TANDEN. Thank you, Chairwoman Murray and Ranking Member Sessions and members of the Committee. My name is Neera Tanden, and I am president of the Center for American Progress. CAP is an independent nonpartisan educational institute dedicated to improving the lives of Americans through progressive ideas and action. We believe that a robust and growing middle class is critical to growing a stronger, more resilient economy and a competitive future. This tenet is one of CAP's core values, and I know that it is a priority for every member of this Committee.

We believe that we should measure our budget priorities against a simple test: Are we expanding opportunity for all Americans? No matter where you come from, we are all better off if everyone in our society has the opportunity to succeed.

Unfortunately, our recent budgets are failing that test. Simply put, many of the budget choices we have made over the past 3 years are hurting people and hindering economic growth.

At a time when we should be doing everything we can to get the economy moving, where everyone is frustrated it is not moving fast enough, instead we have made deep cuts to education, research, infrastructure, and safety net programs. CBO has warned that these austerity policies have made our immediate economic problems worse and now reports that these short-term problems have weakened our long-term economic outlook. High unemployment is driving workers out of the labor force permanently. New capital investment remains relatively low, and less investment now means fewer resources in the future. Weak demand is hurting productivity by making it harder for workers to receive training and for businesses to invest in research and development. We need to solve these problems now, or the economy and American families will struggle for years to come.

What troubles me most about our misguided austerity policies is that Congress has cut the very programs that help low-and middle-income families get ahead. Food stamps and nutrition assistance have been cut. Section 8 housing and welfare are not keeping up with the need. I am concerned about the impact of the cuts to these programs, because I know firsthand I would not be here today if they had not been available to me.

Let me just tell you a little bit about my own story. I grew up the child of two immigrants who had come from India decades earlier. When I was 5, my parents divorced and my dad left. My mother was on her own, and she had never held a job in her life. She had a choice to make at that point. She could go back to India, a woman who had been divorced, with two children, or go on welfare here in the United States to support her two young kids. Now, it was a hard choice for her, but she knew if she went back to India, her children would be stigmatized for the rest of our lives.

So she chose to stay. She went on welfare. As a child, I remember getting those little vouchers to get reduced lunch. It cost 10 cents back then. We were on food stamps. I remember going to the welfare office, and the lines. She stayed in the U.S., and we were on those programs, and we received Section 8 housing as well. But we were lucky to be able to stay in Bedford, Massachusetts, that had good public schools. And after 2 years, she got a job, first at a travel agent office and then a few years later at a defense contractor's offices in Bedford. And eventually, by the time I was 11, she was able to buy her own house in Bedford, Massachusetts.

I know that I am here really because of the incredible tenacity of my mother. But I am also here because there were social safety net programs that were about giving people an opportunity, about giving people a hand when they needed it most.

So I am worried that children today do not have that same social safety net to fall back on, and really the middle class is out of reach for too many families.

As we strive to build an economy that works for everyone, there are a few key policies that would go a long way in rolling back income inequality.

So first, let us stop cutting the programs that help people get into the middle class. Let us invest in job training and other programs to help the unemployed get the skills they need. And, absolutely, we must pass an increase in the minimum wage because that will mean real money in the hands of people who will actually spend it in their local communities and drive jobs. I think that is one of the reasons why The Gap just decided to increase its minimum wage to $10.10.

We also have to ensure that we address the uneven playing field because when wealthy parents have a leg up in providing their children with an environment conducive to long-term success and middle-class and low-income families do not, that is a problem for all of us.

So as the Committee addresses the work it has going forward, I hope you will keep in mind the families here and their struggles and pass minimum wage, address unemployment insurance, and take on the investments we need to make to make the economy grow.

Thank you very much.

[The prepared statement of Ms. Tanden follows:]

# The Economic Budget Outlook for Individuals, Families, and Communities

Testimony before the Senate Budget Committee

By Neera Tanden

February 25, 2014

Thank you Chairman Patty Murray (D-WA) and Ranking Member Jeff Sessions (R-AL) for holding this important hearing on the potential impacts of our budget priorities on everyday Americans.

My name is Neera Tanden, and I am President of the Center for American Progress. CAP is an independent nonpartisan educational institute dedicated to improving the lives of Americans through progressive ideas and action. At CAP, we believe that a robust and growing middle class is vitally important to growing a stronger, more resilient economy and a more competitive future. This tenet is one of CAP's core priorities, and I know that it is a priority for every member of this committee.

We firmly believe that we should measure our budget priorities against a simple test: Are we expanding opportunity for all Americans? No matter where you come from, we are all better off if everyone in our society has the opportunity to succeed.

Unfortunately, our past budgets are failing that test. Simply put, the budget choices we've made over the past three years are hurting people and hindering economic growth.

At a time when we should be doing everything we can to get the economy moving, Congress has instead made deep cuts to education, research, infrastructure, safety net programs, and other important parts of the nondefense discretionary budget. The Congressional Budget Office, or CBO, has frequently warned that these austerity policies have made our immediate economic problems worse, and CBO now reports that these short-term problems have worsened our long-term economic outlook. High unemployment is driving workers out of the labor force permanently. New capital investment remains relatively low, and less investment now means fewer resources in the future. Weak demand is hurting productivity by making it harder for workers to train in new skills and for businesses to invest in research and development. We need to solve these problems now, or the economy will continue to struggle for years to come.

Proponents of austerity policies have argued that our debt represents the most pressing fiscal crisis facing our country. But these arguments ignore the fact that our fiscal outlook has changed considerably over the past three years—specifically, that the federal budget is currently stable, and debt is not out of control. In the five years since President Barack Obama took office, the annual budget deficit has fallen by more than two-thirds as a share of our economy.[1] Looking ahead, the cumulative national debt will actually shrink in each of the next three years as a share of the economy.[2] We still have some long-term budget challenges, but solutions to these challenges are manageable as long as revenues are considered along with spending.

What troubles me most about our misguided austerity policies is that Congress has slashed the very programs that help low- and middle-income families get ahead. Food stamps have been cut. Proposals to cut nutrition aid would drop children from school lunch programs. Section 8 housing and welfare aren't keeping up with the need. I'm concerned about how the attack on these programs is going to impact people in our country because I know that I wouldn't be here today if they hadn't been available to me.

I grew up in a suburb of Boston, the child of two immigrants who had come from India decades earlier. We lived in a house in Bedford, Massachusetts, a quintessential middle-class town. But when I was 5, my parents divorced, and my dad left. My mother was on her own. Having never held a job before, she had to choose: Go back to India or go on welfare to support her two young children. In India, we would have been stigmatized, and she knew our life chances would be limited; it was unheard of to get divorced back then.

So we stayed. We were on welfare. We were on food stamps. We received Section 8 housing vouchers to help pay the rent. I paid less for lunch because of the free and reduced lunch program. We were lucky to be able to remain in our town's high-quality public schools. My mom eventually got a job as a travel agent and went on to become a contracts administrator for a defense company. By the time I was 11, I'm proud to say, she bought her own home in Bedford.

My mom is an amazing woman who sacrificed a great deal for her children. I know that whatever success I've achieved in life is thanks to my mother's tenacity and her commitment to giving each of her children a better life. But I also know I'm where I am today because our social safety net gave my mother the resources she needed to get back on her feet. She was lucky to live in a country that says, "Just because you're down, it doesn't mean you're out." And without those supports, I would never have had the opportunities that I've had in my adult life and probably wouldn't be sitting here today.

Yet today, our country's commitment to this basic creed is under fire. The middle class is out of reach for too many families who are living paycheck to paycheck. As we strive to build an economy that works for everyone and not just the wealthy, there are a few key policies that would go a long way toward rolling back income inequality in both the short and long terms. While these policies by no means represent all that must be done to address the current economic imbalance, they represent common-sense approaches that could help jumpstart our economy and increase opportunity for all Americans.

First, let's stop cutting those initiatives that are about helping people into the middle class. With the share of long-term unemployed workers near its highest point, we must extend emergency unemployment insurance, which provides millions of struggling families with a vital economic lifeline. And as we help these workers get back on their feet, we should be expanding—not cutting—job training, which is so crucial in helping the unemployed acquire the new skills they need to find work. We also need to restore recent cuts made to nutrition assistance programs such as the Supplemental Nutrition Assistance Program, or SNAP, which helps working families, veterans, and seniors who are struggling to afford food.

## Raise the federal minimum wage

But beyond the budget, we should raise the federal minimum wage to $10.10 per hour, as Sen. Tom Harkin (D-IA) has proposed. Currently, a full-time worker making the minimum wage earns just $15,080 per year.[3] For a family of three, that is $4,000 below the federal poverty line.[4] Raising the minimum wage to $10.10 would increase yearly earnings to $19,777.[5] It would directly raise the wages of 16.5 million American workers and would lift almost 1 million Americans out of poverty.[6] These workers are not just teenagers. Nearly 90 percent of minimum-wage workers are 20 years old or older, and the average minimum-wage worker is 35 years old.[7] About two-thirds of all workers who are paid minimum wage or less are women.[8]

We're already seeing businesses, such as the Gap, Costco, and Whole Foods, adopt this strategy because they understand that a fair wage is good for their companies' profits and reputations. Raising the wages of frontline workers helps minimize employee turnover, encourage hard work, and increase employee productivity, commitment, and loyalty.[9] Cities, counties, and states, such as Washington, D.C.; Montgomery County, Maryland; and California, have also adopted measures to raise the incomes of their lowest-paid workers because they know that if workers can earn a living wage, it will help grow their local economies. More than half of the states that raised the minimum wage during periods of high unemployment saw their unemployment decrease over the next 12 months.[10]

It's no surprise, then, that the bulk of academic studies have found little to no effect on employment from raising the minimum wage at the level being discussed.[11] More than 600 economists, including seven Nobel laureates, confirmed this recently in a letter that supported an increase in the minimum wage.[12] They argued that it will improve our economy and create jobs and that recent academic research showed that "increases in the minimum wage have had little or no negative effect on the employment of minimum-wage workers, even during times of weakness in the labor market."[13]

Raising the minimum wage isn't just smart policy for low-wage workers; this is smart policy for our entire nation. If all low-wage workers earn more, virtually every American business would have more customers, and every taxpayer would have to spend less on poverty programs. More spending in the local economy means more jobs, which in turn means stronger communities and a stronger economy.

## Guarantee workers paid sick days and family leave

As the president said during the State of the Union, America succeeds when women succeed. Because the economy succeeds when women and their families succeed. Today, approximately 100 million private-sector American workers lack paid family leave to care for a new child or an aging parent.[14] In fact, we are the only advanced nation in the world that does not guarantee mothers paid time off to care for a new child. As a leading nation, we need to adopt workplace policies that expand opportunities for both mothers and fathers. Middle-class parents need access to workplace policies such as paid sick days and paid family leave to ensure that they can balance the demands of parenthood with the demands of their jobs.

Low-wage workers and workers of color are especially out of luck. A whopping 80 percent of low-wage workers lack access to paid sick days,[15] and 40 million Americans struggle with the choice between working while sick or losing a day's pay.[16] Workers of color are more likely to find themselves in these types of low-wage jobs. Despite meaningful gains in employment and education, people of color continue to face inequality in the workplace—and the negative impacts of this inequality are passed on to their children. From higher levels of unemployment to even lower wages, their struggles highlight the need to adopt policies that allow for workplace flexibility.

Guaranteeing workers access to paid leave and sick days will help the working son care for his ailing father, a loving mother and father care for their newborn child, and the employee recover from a serious illness without financially suffering even more from life's unexpected twists and turns. It will increase labor-force participation, employee retention, and lifetime earnings, as well as increase the parental involvement of working fathers.[17] Businesses will be able to attract higher-quality workers, reduce absenteeism and tardiness among employees, and reduce employee turnover.[18] Offering paid leave and sick days to all Americans will provide security for our nation's workers, employers, and economy.

## Ensure universal access to high-quality preschool

If we wish to address inequality in this country, we need to start at the origins of the educational achievement gap and invest in children from birth. Bold initiatives to expand universal access to high-quality early education will combat inequality for the next generation and build the workforce our businesses need to compete in the global economy.

Researchers estimate that half of the achievement gap in high school can be attributed to children's experiences before age 5.[19] Children begin learning at birth, and research has shown that the first signs of an achievement gap appear as early as 18 months of age.[20] This gap only widens throughout early childhood.[21] By age 4, children of wealthier parents have heard 30 million more words than low-income children.[22]

The good news is that we have proven tools to address this issue. We know that children who attend high-quality early childhood programs benefit throughout their lifetimes: They are more likely to graduate from high school, attend college, and earn higher wages as adults. A large federal investment in preschool, coupled with investments from birth in child care, home visiting, and Early Head Start, would greatly expand the number of low-income children who have access to high-quality early childhood programs and make headway in closing the school-readiness gap. Already, 40 states have implemented preschool programs.[23] Contemporary high-quality preschool programs in Tulsa, Oklahoma, and Boston, Massachusetts, have shown that in one year of attendance, children can make up six months to one year of learning in reading and math.[24] Similarly, evaluations of preschool programs across multiple states confirm large gains for children.

But states cannot do this alone. Despite more than a decade of state investments in preschool, states serve just 28 percent of 4-year-olds.[25] Preschool enrollment has increased among children nationwide, but the lowest-income and most-disadvantaged children continue to struggle for access to these programs. Among 3-year-olds in low-income families, only 42 percent of children participate in preschool programs.[26] Of 3-year-olds in middle-income families, this number falls to a staggering 34 percent.[27] Offering universal access to high-quality early education can ensure that all children, regardless of their backgrounds, start on a more level playing field, thereby combating inequality for the next generation of Americans.

## Invest in public education

To help break the cycle of poverty and build the middle class, our commitment to education must extend beyond early childhood. While school funding is heavily dependent on state and local dollars, ensuring that our schools are fully funded is a national priority that demands a national response—especially with respect to low-income schools that cannot raise adequate funds from their own communities. Funding for grants administered through Title I of the Elementary and Secondary Education Act, the primary method by which federal funding is distributed to low-income schools, must be increased to ensure that all children have a fair, equal, and significant opportunity to obtain a high-quality education. We must also ensure that our teachers are soundly supported. Decades of research show that teachers and school leaders are the key in-school factors to improving student learning. Programs such as the Teacher Incentive Fund, or TIF, help districts and schools attract and retain talented teachers, as well as improve the instructional practice of teachers already in the classroom and address the shortage of effective teachers in math and science.[28]

## Train our workforce to compete in the global economy

To address income inequality, funding quality public education alone is not enough. We need to make sure we're building the workforce that our businesses need to compete in the global economy. Unfortunately, our workforce training system is woefully out of date and underfunded. It should help workers build long-term skills, not just push them into the first jobs they find. Training partnerships such as apprenticeships are a great place to start.

Apprenticeships are a structured form of paid worker training that have been shown to boost workers' earnings and raise sponsoring companies' productivity levels. Apprenticeships benefit workers by connecting them with a paid job now while providing them with valuable workforce skills. This is especially important for young people, as the unemployment rate for Americans under age 25 is still at an astonishing 11.9 percent among youth ages 20 to 24.[29] In many apprenticeship programs, apprentices can earn college credit for their coursework and on-the-job training. The prospect of debt-free education is particularly appealing to young people today, who are facing college costs that have increased by 250 percent for public four-year universities[30] in the past three decades and an average student-loan balance of $25,000.[31]

Expanding the U.S. apprenticeship system, both in numbers and occupational opportunities, would strengthen the American economy by helping businesses meet the demand for skilled workers while offering workers higher wages and better employment outcomes.

## Invest in scientific research

Ensuring American businesses have a fully trained workforce is a critical step toward ensuring our country can compete in the global marketplace. But to truly boost competitiveness, we must also redouble our commitment to funding scientific research and development.

World-class research is a major source of our nation's economic strength. In fact, economists believe that up to half of the United States' economic growth since World War II can be attributed to innovation.[32] Groundbreaking technologies, such as the Internet and the Human Genome Project, were developed in part as a result of federally funded research.[33]

Many significant scientific discoveries begin as basic research that can take decades to fully develop. Because the commercial applications of this research may not be initially apparent, private industry often lacks the incentive to invest in research and development projects. Without federal funding, much of this research might never take place.

Despite the critical role the federal government plays in promoting innovation, recent cuts to investments in scientific funding have put our long-term competitiveness at risk. In this fiscal year alone, federal funding for the National Institutes of Health and the National Science Foundation has been slashed by almost $800 million below last year's levels.[34] These cuts jeopardize critical advancements in medical and other scientific research. To ensure America remains a leader in the technological innovation that is so critical to economic growth, Congress must reverse this trend and invest more heavily in scientific research and development.

## Conclusion

The policies I've outlined—raising the minimum wage, guaranteeing workers paid sick days and family leave, funding high-quality public education at every level starting with universal pre-K, creating training partnerships to help build a highly qualified workforce, and investing in research to help boost U.S. competitiveness—are not only good for individuals, families, and communities; they're also essential for our economy. There is no single silver bullet to get our economy working again and to roll back decades of rising income inequality. But there is no doubt in my mind that a rising, thriving middle class is the true engine of America's economic growth—not just a consequence of it.

Strengthening the middle class is all about developing and empowering our most precious resource—our people. It's about creating a stable source of demand for goods and services. It's about incubating the next generation of entrepreneurs who can change the way we look at and interact with the world. Above all, it's about an economy that allows anyone to succeed and propel our nation forward. It's a simple formula: Raise the wages of workers today, give children a fairer shot out of the gate, improve opportunities for young people to learn and hone their skills, and provide sufficient resources to help boost U.S. competitiveness.

Thank you, and I look forward to answering your questions.

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Chairman MURRAY. Thank you very much.
Mr. DOAR.

**STATEMENT OF ROBERT DOAR, FORMER COMMISSIONER, NEW YORK CITY HUMAN RESOURCES ADMINISTRATION, AND MORGRIDGE FELLOW IN POVERTY STUDIES, AMERICAN ENTERPRISE INSTITUTE**

Mr. DOAR. Thank you, Chairman Murray, Ranking Member Sessions, and other members of the Senate Budget Committee, for inviting me to testify today.

In looking at the conditions, prospects, and possible solutions for low-income Americans, I have four main points, all of which have been informed by my work in New York City for former Mayor Michael Bloomberg, where for 7 years I ran one of the Nation's largest social services agencies.

First, things are not good for struggling Americans. More than 50 months after the end of the recession, millions of Americans are still unemployed, 3.6 million have been jobless for more than 27 weeks, 7.3 million are involuntarily working part-time, and the labor force participation rate is still too low. As a result, some 46 million Americans are living below the Nation's official poverty line.

From my experience in New York, I believe I have an understanding of what works to increase the livelihood of struggling Americans. A stronger economy works to help the poor. But in order for that to happen, we need leaders who are focused on protecting and growing job opportunities.

In New York City, we nurtured a strong and vibrant economy, providing an abundance of job opportunities for low-skilled New Yorkers. New York City's job recovery from the recession has been much, much faster than the rest of the country, and it is partly due to that vibrant economy that New York City is the only city among the Nation's 20 largest cities not to have seen an increase in poverty since the 2000 census. In fact, the average increase in the Nation's other major cities has been 36 percent, and across the whole Nation, the increase has been 28 percent. In New York City, zero. And that is after the deepest national recession since the Great Depression.

Work expectations and requirements in public assistance programs also have been successful. We need to replicate the success of welfare reform and the TANF program in other public assistance programs. At the job centers in New York, we required a minimum number of hours of work or work-like activity for all welfare applicants and recipients, and we extended that requirement to able-bodied adults without children in the food stamp program. And our employment programs, which we paid for based on job placements not process, were able to absorb that increased demand.

We need to reward work with available and sometimes more generous supports such as the earned income tax credit. New Yorkers receive the most generous EITC in the Nation, and we made sure food stamp benefits, child care assistance, child support collections, and public health insurance were available to low-income working New Yorkers.

Finally, we need policies and messages which foster stronger families. There just is not any doubt that fewer Americans will be poor if more children are raised in two-parent married households. I do not want to impose my culture on anyone, but I do want to be honest and I want our leading institutions to be honest about the consequences for our society of an increasing portion of our population being raised in single-parent families.

The Bloomberg administration implemented a path-breaking public service advertising campaign which highlighted the consequences for children of teen pregnancy. We need to replicate that campaign on a much larger scale.

Going forward, we need policies which create jobs, not shrink them, and we need to be especially protective of industries which provide entry-level opportunities: tourism, security, and retail. We need to impose welfare reform-like requirements on public assistance programs in return for assistance. We need to reward work with better targeted and more generous EITC, especially for single individuals, and we all need to participate in an honest discussion about good personal choices that will lead to better outcomes for children and families. And we should recognize and celebrate the value of low-conflict marriage for children.

I would ask the Committee to consider a more generous EITC for childless adults, support programs which target poor young men, and test the two-generation programmatic approach which helps both parents and children under the same organizational structure.

And, finally, the Committee should support relocation assistance so unemployed Americans can get help moving to areas where there are more jobs.

Thank you.

[The prepared statement of Mr. Doar follows:]

American Enterprise Institute
for Public Policy Research

Statement before the U.S Senate Committee on the Budget

# Back to Work:
# How to improve the prospects of low-income Americans

February 25, 2014

**Robert Doar**
Morgridge Fellow in Poverty Studies
American Enterprise Institute

*The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.*

Chairman Murray, Ranking Member Sessions, and other members of the committee, thank you for the opportunity to testify today before the Senate Committee on the Budget on the economic outlook of individuals, families, and communities.

My remarks will focus on how we, as a nation, can do a better job of helping poor Americans. I will lead with my summation:

I. **The economic status and outlook for low-income Americans is not as strong as it could be or as it should be;**

II. **Policymakers should adhere to the following principles to enhance the well-being of and opportunity of economically vulnerable working-age Americans:**

1. Foster more and better work opportunities;
2. Require work as a condition of means-tested public assistance;
3. Reward work with robust support for those working at low wages;
4. Foster two-parent married families.

III. **I recommend the following policies:**

1. Stronger work requirements for public assistance programs;
2. Better targeted and sometimes more generous work supports to make low wages stretch farther;
3. Mitigate marriage penalties embedded in means-tested welfare programs and send honest public messages about the significant challenges of raising children in single parent families.
4. Targeted programs for young men and young parents in poor communities;
5. Pro job-growth and labor mobility policy, specifically relocation assistance for the unemployed;

**I. Low-income Americans are struggling**

The lackluster economic recovery—which is now more than 50 months old—has not brought relief to American individuals, families and communities. According to the latest data from the Bureau of Labor Statistics, 10.2 million Americans are unemployed. 3.6 million have been jobless for more than 27 weeks. 7.3 million are involuntarily working part-time. And 837,000 workers are so discouraged, they have stopped looking[1].

The unemployment rate has fallen substantially from a peak of 10 percent in October 2009 to its current 6.6 percent, but those numbers tell a false tale of the recovery. A smaller share of working-age Americans are either working or looking for work than five years ago. In October 2009, 65 percent of Americans age 16 and older were participating in the labor force. As of January 2014, 63 percent were[2].

1 Bureau of Labor Statistics. <http://www.bls.gov/news.release/empsit.nr0.htm>. Accessed 7 February 2014.

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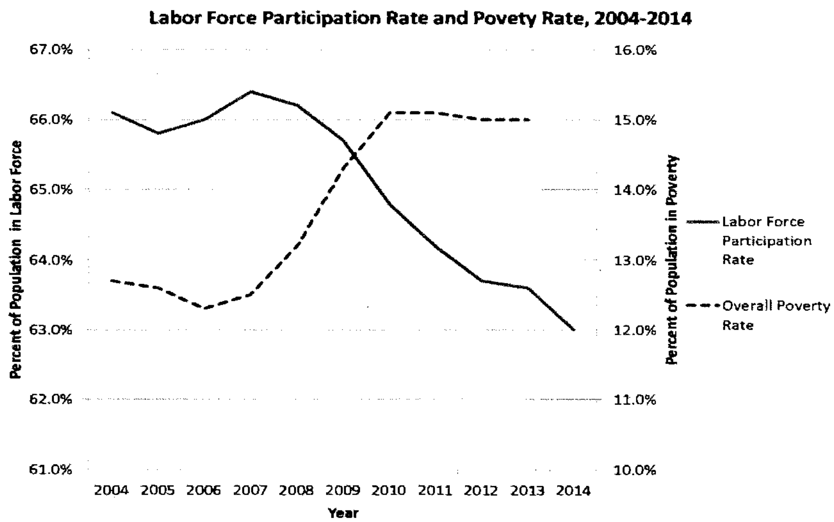
The average American household is also earning less than it did five years ago. From 2007 through 2012, the inflation-adjusted median household income dropped from $55,627 to $51,017.

These trends have hurt the most economically vulnerable. As work participation has fallen, the official poverty rate has risen. In 2007, 12.5 percent of Americans were living below the poverty line. Now, 15 percent do. In 2007, 18 percent of children lived below the poverty line. Now 21.8 percent do[3]. The official poverty rate is seriously flawed in that it overstates the material hardship faced by low income Americans by not taking into account much of what government provides in assistance. But as an indication of the extent to which Americans are not earning a minimum income through their own work, the most recent official poverty numbers tell a very disturbing story.




*Source: US Census Bureau and Bureau of Labor Statistics*

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## II. Principles for helping poor Americans

I have spent the last 18 years working on these issues for both New York State and New York City. I have found that there are certain essential ingredients to successful public assistance programs.

1. *Work requirements as a condition of public assistance.* Not working is the quickest pathway to poverty in the United States. In 2012, 60 percent of the poor ages 18-64 did not work at least one week out of the year. In contrast, the poverty rate for full-time, year-round workers was 2.9 percent[4]. A strong work-first approach must be central to public assistance programs. The work first approach has been shown to have better outcomes with regard to attachment to the labor force than approaches which focus on training and education. If the goal of public assistance is to help the poor lift themselves out of poverty and into self-sufficiency, then work requirements as a condition of that help must be central.

2. *Robust work supports for those who are working at low wages.* In many areas—like New York City—it is difficult to make ends meet while working at low wages. We need to recognize that, and provide supports that honor and supplement the work efforts of low-income Americans without discouraging them from work. The Earned Income Tax Credit, child care assistance, public health insurance, food stamp benefits and child support enforcement collections can all be important work supports that make earnings go farther for a family.

3. *Business growth and investment.* In New York City, I was fortunate to benefit from an economy that though impacted by the recession recovered much sooner than the nation as a whole. Even during the national recession, our welfare to work program was able to find thousands of employment opportunities and that strong economy was a key reason that thousands of low-income citizens were able to leave the welfare rolls. The same is not the case nationwide: New York City was the only city among the nation's 20 largest that has not seen an increase in poverty since 2001[5]. Policies, both at the national and state level that raise the cost of doing business and deter growth do little to create what the poor need most: jobs.

4. *Foster married, two-parent families.* The consensus view of academic research, and of common sense, is that children raised in married, two-parent families are more likely to be successful than those raised by single parents. Yet many public assistance programs are structured in ways that provide greater financial benefits to single parent families than married families. And unfortunately most of our leading institutions—and leaders—shy away from reiterating that children are less likely to grow up in poverty if they are born into married two-parent families. We need to mitigate marriage penalties in public assistance programs and we need to be honest about the consequences for children of single parenthood.

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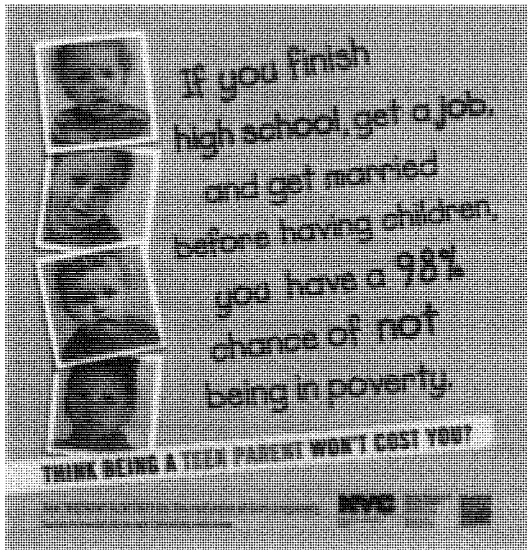
4 United States Census Bureau. "Income, Poverty, and Health Insurance Coverage in the United States." <http://www.census.gov/prod/2013pubs/p60-245.pdf>. September 2013

5 Office of the Mayor, City of New York. "Mayor Bloomberg Receives Award for Anti-poverty Efforts." <http://www1.nyc.gov/office-of-the-mayor/news/367-13/mayor-bloomberg-receives-award-anti-poverty-efforts-children-s-aid-society-releases-new/#/0>. 14 November 2013.




*Source: New York City Human Resources Administration, Department of Social Services*

**III. Policy reforms that should be explored**

**1. Work Requirements**

Work requirements were a key element of the 1996 welfare reform. They created a reciprocal relationship between low-income Americans and the government. In the words of then-President Bill Clinton, the work requirement helped "make welfare a second chance, not a way of life.[6]" Women on welfare had been told they couldn't work. After reform, employment among never-married mothers soared from 44 percent to more than 65 percent[7]. The work requirement was critically important to that success.

Given that work is proven to help low-income Americans rise out of poverty, tightly-administered work requirements must be a condition of support in current and future programs. During my time in New York City, we took these requirements very seriously. If an individual qualified for cash assistance but was not employed, we required his participation in an employment program. If an individual without children in the household qualified for food stamps, was not employed, and was able to work, we required her participation in an employment program. With those clear expectations in place, we were able to help

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6 Clinton, Bill. "How We Ended Welfare, Together." *The New York Times*. 21 Aug. 2006. Web. 23 Feb. 2014.

7 Haskins, Ron. *Work Over Welfare: The Inside Story of the 1996 Welfare Reform Law.* Brookings Institution Press 2006, p. 335.

hundreds of thousands of New Yorkers move from welfare to work, reducing the City's welfare caseload from 1.1 million under Mayor Giuliani to 346,000 at the end of the Bloomberg administration.

Many states and localities—and the federal government—have not taken these requirements as seriously as we did in New York. Given the body of research demonstrating that work-first is the most effective way of helping Americans help themselves, this needs to change[8].

**2. Work Supports**

Low-income Americans must know that work is expected and also rewarded. To that end, there is merit in seriously considering how work supports could be improved—and in some cases made more generous. In my experience in New York City, programs like Medicaid, child care assistance, and child support collections—taken as whole—were very helpful at keeping people working, moving up, and rising out of poverty.

One of the most successful work support programs, the Earned Income Tax Credit (EITC), has proven very successful in this regard. Yet given the economic situation faced by many low-income Americans, enhancement of the EITC should be carefully considered, especially for single Americans and non-custodial parents.

*The Earned Income Tax Credit (EITC)*

The EITC is one of the most important federal anti-poverty programs currently in existence, and is estimated to have lifted 6.5 million Americans out of poverty in 2012[9]. The EITC is also notable in that it was designed to encourage work, and has been successful in doing so. A review of welfare reform policies in the 1990s by Dr. Jeffrey Grogger showed that the EITC helped raise the employment and earnings of female-led households, and led to a decrease in welfare use[10].

But there are opportunities to improve the EITC: it leaves single individuals—most notably non-custodial fathers —without much financial support at all. The maximum benefit for singles is capped at $487, while being much more generous for household with children, offering a maximum benefit of more than $6,000 for workers with three or more children.

Although it makes sense to have larger benefits for parents, there are reasons now that expanding the EITC for non-parents and non-custodial parents makes sense as well.

First, non-custodial parents—particularly fathers—are among the most economically vulnerable and societally detached groups of adults. A 2001 study by Sorensen and Zibman found that only 36 percent

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8 Brown, Amy, "ReWORKing Welfare." U.S. Department of Health and Human Services. <http://aspe.hhs.gov/hsp/isp/work1st/pt1.htm>. March 1997.

9 Center on Budget and Policy Priorities, "Policy Basics: The Earned Income Tax Credit," < http://www.cbpp.org/cms/?fa=view&id=2505>. January 31, 2014.

10 Grogger, Jeffrey, "The Effect of Time Limits, The EITC, and Other Policy Changes on Welfare Use, Work, and Income Among Female-Headed Families," *The Review of Economics and Statistics*, May 2003, Vol. 85 (2), p. 394-408.

of the 11 million non-custodial fathers paid child support. Of those who did not pay support, 23 percent were poor, 60 percent were minority, and 42 percent had not finished high school[11]. This group of Americans—even more than other vulnerable populations—is struggling. This impacts not only their own well-being, but their ability to contribute financially and personally to the lives of their children and mothers.

Second, current policy does little to encourage them to help themselves and their families through work: a non-custodial father working full time at minimum wage would not be eligible for EITC support. Public policy enforces appropriate responsibilities for non-custodial parents—in the form of child support obligations—but it provides few carrots. Enhancing the EITC for this group of Americans could help.

Third, the expansion of other programs that provide benefits to single Americans—but do not encourage work—make supports that do require work more critical. The Affordable Care Act, for example, significantly expanded Medicaid for low-income singles and non-custodial parents. By providing support detached from work effort, such expansions lower the incentive to work. Targeted EITC expansion could help offset these disincentives.

Given the EITC's success in encouraging workers with children to enter the labor force and continue working, it makes sense to re-evaluate how the EITC works for single non-parents and non-custodial parents.

**3. Better family policy**

When it comes to promoting the benefits of two-parent married families for children, I do not want to stigmatize or impose my culture on others. But I do want to be honest. The consensus of academic research is that married parents are good for children. A recent study by Harvard economist Raj Chetty and colleagues looked at the best available community-level data on mobility in America, seeking the strongest predictor of upward mobility for children. They found that,

> *"The fraction of children living in single-parent households is the strongest correlote of upward income mobility among all the variables we explored"*[12]

Family structure was more predictive of mobility than race, income inequality, or educational opportunity. The authors' findings are consistent with a large body of academic work showing that children are most likely to thrive in a stable two-parent, married family; for instance, Child Trends noted that "research clearly demonstrates that family structure matters for children, and the family structure that helps children the most is a family headed by two biological parents in a low-conflict marriage."[13] If

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11 Lucky, Irene and Lisa Potts, 2010. "Alternative to incarceration for low-income non-custodial parents." Child and Family Social Work, 2010.`http://www.scfathersandfamilies.com/public/docs/1330102066.pdf>.

12 Chetty, Raj et al., 2014 "Where is the Land of Opportunity? The geography of intergenerational mobility in the United States"NBER Working Paper 19843. <http://obs.rc.fas.harvard.edu/chetty/mobility_geo.pdf>.

13 http://www.childtrends.org/wp-content/uploads/2013/03/MarriageRB602.pdf. See, also, Paul Amato, 2005, http://futureofchildren.org/futureofchildren/publications/docs/15_02_05.pdf

we are serious about addressing child mobility, we must be willing to talk honestly about the role of one of its most influential predictors: family structure.

*Marriage penalties*

Recognizing that married, two-parent families help poor children succeed, we must address policies that make marriage hard—especially among low- and middle-income Americans. Marriage penalties can be especially discouraging for those individuals who have the least freedom to forego income. As Eugene Steuerle of the Tax Policy Center and colleagues have explored in detail, policies aimed at assisting low- and moderate-income households with children often penalize marriage. Take this example:

> *A single parent with two children who earns $15,000 enjoys an EITC benefit of about $4100. The credit decreases by 21.06 cents for every dollar a married couple earns above $15040....[I]f the single parent marries someone earning $10,000, for a combined income of $25,000, the EITC benefit will drop to about $2,200. The couple faces a marriage tax penalty of...$1,900."*[14]

Similar penalties are embedded in Medicaid, Temporary Assistance for Needy Families (TANF), food stamps, housing assistance, and child care—all of which apply to low- and moderate-income Americans. Efforts to mitigate marriage penalties have largely taken the form of tax cuts directed toward married couples. But according to Carasso and Steuerle's analysis, 81 percent of that relief flowed to couples earning above $75,000.

A host of reforms could alleviate this burden. As Carasso and Steuerle describe, implementing a maximum marginal tax rate for low-income families would tamp marriage-induced hikes in rates. Providing a subsidy on individual earnings—not combined earnings (like the EITC)—would enable a low-wage American to marry someone with a child, but do so without sacrificing significant income or transfer payments. And mandatory individual filing, as done in Canada, Australia, Italy and Japan, would either require or allow low-income individuals to avoid income tax penalties.

The first step, however, is to recognize that tax policy and social services program structures hinder an institution that is vital to the flourishing of poor children. We need to find a way to address it.

**4. Targeted programs for the most vulnerable**

Programs targeted toward the most vulnerable Americans, particularly young men and young parents in poor communities, attack intergenerational poverty head-on. Though these programs are still in developmental stages, they deserve attention and could serve as models for larger state- or national programs.

*Two-gen programs*

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14 Carasso, Adam, and C. Eugene Steuerle. "The Hefty Penalty on Marriage Facing Many Households with Children." *The Future of Children* 15.2 (2005): 157-75. <http://futureofchildren.org/futureofchildren/publications/docs/15_02_09.pdf>.

Two generation programs operate on the premise that vulnerable households are best helped with simultaneous supports for both child and parent. By combining pre-k and early childhood education for children with work programs, parenting classes, fatherhood education and marriage counseling for adults, the programs seek to create a better foundation for regular work, healthy homes, and smart children.

Programs like AVANCE in Texas and New Mexico, INPEACE in Hawaii, and Career Advance in Oklahoma are examples of such initiatives. We need to nurture these types of programs, while carefully evaluating them with randomized assignment studies—and replicate them if they are shown to be successful.

*Programs for young men*

Young minority men are disproportionately poor and unemployed, have higher rates of crime, and drop out of high school more often than whites. Programs—often joint public-private efforts at the local level—need to tackle that problem and connect young minority men to educational, employment, and mentoring opportunities.

Mayor Bloomberg's Young Men's Initiative in New York City is one such program. A coordinated program across thirteen separate agencies, the initiative works to prepare young men of color to compete with their peers in the classroom and in the workplace, equip them to be responsible fathers, and help a run-in with the criminal justice system from defining a young man's life through mentoring, case management, and therapy[15].

Chicago has pioneered a highly successful "Becoming a Man" initiative targeted toward at-risk males grades 7-12. That program focuses on developing the social-cognitive skills that reduce violence and anti-social behavior[16]. In a randomized trial conducted by the University of Chicago Crime Lab, B.A.M was shows to reduce violent crime arrests by 44 percent; reduce the likelihood of attending school in a juvenile justice setting by 53 percent; and increase graduation rates by 10-23 percent.

The Doe Fund in New York City helps largely minority men get back to work more directly with a 6-9 month program that fosters a strong work and drug free environment. It offers and enforces a contract: If you get up every day and go to work and stay drug free, we will pay you and house you and feed you[17]. And its average graduate has a starting wage of $10.88 per hour.

President Obama has announced a broader initiative, "My Brother's Keeper," which seeks to target the same population at larger scale. Though the details of this program have not yet been announced, it is encouraging to see thoughtful engagement of the issue at the federal level.

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15 "Young Men's Initiative." *Young Men's Initiative.* City of New York, n.d. Web. 23 Feb. 2014. <http://www.nyc.gov/html/ymi/html/home/home.shtml>.

16 "B.A.M. – Becoming A Man." Youth Guidance, 2012. Web. 23 Feb. 2014. <http://www.youth-guidance.org/our-programs/b-a-m-becoming-a-man/>.

17 "Ready, Willing & Able." The Doe Fund, n.d. Web. 19 Feb. 2014. <http://www.doe.org/>.

*Programs for Young Parents*

64 percent of African-American lived apart from their biological fathers in 2012[18]. Such children are more likely to grow up in poverty, drop out of school, and become either single mothers or non-custodial fathers. Initiatives to help young parents improve their parenting practices and family life show some promise in breaking this cycle.

The bulk of these programs capitalize on the moment of childbirth to bring parents together and engage fathers in the lives of their children and mothers. A 2010 study by Philip Cowan and colleagues reviewed a broad range of couple-oriented family strengthening programs. Though the data on such programs are far from robust, the authors find that some such programs positively impact father involvement, marriage health, and child outcomes[19].

**5. Encouraging Job Growth and Mobility**

What low-income Americans need most is work. Policies that lend businesses the confidence they need to invest and grow are also policies that will help the poor. Conversely, policies that reduce job growth hurt the poor. I do not pretend to be an economist, but I do know how the slow economy made work harder to find and hold for many low-income New Yorkers, and am keenly aware of the impact of burdensome regulation and policy on the economic well-being of vulnerable Americans.

*The impact of public policy on work*

At this particularly difficult time for American families we cannot be indifferent to the effect on the labor market of our public policies.

At least so far, the Affordable Care Act has done little to foster the participation of low-income Americans in the work force. The Congressional Budget Office estimates that the ACA will reduce full-time equivalent employment by 2.3 million jobs by 2021[20]. Policies, like the ACA, that reduce labor supply and total hours worked in the economy are indifferent at best and harmful at worst to the goal of full time, year-round work that is the most direct poverty-protection mechanism.

Recent proposals to raise the minimum wage would not help the prospects of the most poor Americans. A recent study by Joseph Sabia and Richard Burkhauser found that only 11.3 percent of individuals who would benefit from raising the minimum wage to $9.50 per hour were living below the poverty line. 42.3 percent of those who would benefit live in households with incomes three times the poverty line[21]. And

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18 Solomon-Fears, Carmen Solomon-Fears, Gene Falk, and Adrienne Fernandes-Alcantara. "Child Well-Being and Noncustodial Fathers." Congressional Budget Office, 12 Feb. 2013. Web. 19 Feb. 2014.

19 Cowan, Philip A., Carolyn Pape Cowan, and Virginia Knox. "Marriage and Fatherhood Programs." *The Future of Children* 20.2 (2010): 205-30. Print.

20 *The Budget and Economic Outlook: 2014 to 2024*. Congressional Budget Office, 4 Feb. 2014. Web. 23 Feb. 2014.

21 Sabia, Joseph J., and Richard V. Burkhauser. "Minimum Wages and Poverty: Will a $9.50 Federal Minimum Wage Really Help the Working Poor?" *Southern Economic Journal* 76.3 (2010): 592-623. Web. <http://www.people.vcu.edu/~lrazzolini/GR2010.pdf>.

a recent study released by the Congressional Budget Office estimated that raising the minimum wage to $10.10 per hour could lead to lost jobs for hundreds of thousands of workers[22].

Direct work supports provide a much better avenue for raising the incomes of working families, and would do so without damaging an already tenuous job market. They might cost a little more for American taxpayers, but they do not lower the number of jobs available for those who need them.

*Work Relocation Vouchers*

We also need to do a better job of physically connecting individuals with work. While some regions have a strong demand for workers, others do not. We need to acknowledge that, and help Americans take advantage of better opportunities. My colleague Michael Strain has proposed work relocation vouchers as one way to lower barriers to work for low-income Americans.

In the U.S. today many communities are plagued by very high levels of unemployment, such as Yuma, Arizona, whose December 2013 unemployment rate was 27.1 percent. Unemployment in other areas, like Providence, RI, is less severe but still 50 percent higher than the national average: 9.2 percent versus 6.5 percent nationally. In contrast, regions with strong job growth have very low levels of unemployment. Midland, Texas, for example, has an unemployment rate of 2.8 percent, and the Minneapolis-St.Paul area, 4.3 percent[23]. Unemployed workers in high unemployment regions will have a much more difficult task of finding and maintaining full time work than they would in low unemployment regions, where jobs are more plentiful.

The problem is that many unemployed workers—especially the long-term unemployed--lack the financial resources and information about the labor market that would allow them to move to areas where job growth is stronger and the chances of securing employment are higher. Relocation vouchers would target unemployed workers in areas with elevated levels of unemployment and provide them with a grant – potentially using funds from the unemployment insurance pool—to move to an area with a lower than average unemployment rate.

**Conclusion**

Low-income Americans are struggling. Labor force participation has fallen, poverty rates have risen, and median incomes have stagnated. The best and most proven path out of poverty is work, and our policies should do a better job of encouraging it.

My experience in New York City leads me to suggest that strengthening work requirements in means-tested social services; rewarding work by enhancing programs that support Americans working at low wages; being honest about the benefits of marriage for children and minimizing the impacts of policies

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22 *The Effects of a Minimum-Wage Increase on Employment and Family Income*. Congressional Budget Office, 18 Feb. 2014. Web. 19 Feb. 2014. <http://www.cbo.gov/publication/44995>.

23 Unemployment data from the Bureau of Labor Statistics, "Metropolitan Area Employment and Unemployment Summary," February 5, 2013.

that discourage it; promoting proven programs for young men and young parents; and advancing policies that strengthen the economy and connect Americans to work are the best ways to give struggling Americans a hand up, and help them get on a path toward success.

Thank you for the opportunity to share my views on this important issue.

Chairman MURRAY. Thank you.
Dr. Winship?

**STATEMENT OF SCOTT WINSHIP, PH.D., WALTER B. WRISTON FELLOW, MANHATTAN INSTITUTE FOR POLICY RESEARCH**

Mr. WINSHIP. Thank you. Chairman Murray, Ranking Member Sessions, members of the Committee, thank you for inviting me to appear today to discuss the outlook for the Nation's economy and budget. As we enter budget season, with the Great Recession growing dimmer in our rearview mirror but significant economic anxiety still riding shotgun, it is important to assess where we have been and where we stand, to carefully distinguish between short-and long-run challenges, and to prioritize among them. My written testimony reviews the long-term trends in household income earnings inequality and mobility and points to three conclusions for policy that I will highlight here this morning.

Many of the statistics I cite will appear at odds with the lived experience of Ms. Kimball and Ms. Johnson and their communities. Nothing I say is meant to minimize their challenges or to contest their stories. But as a researcher, I rely on statistics, which are impersonal but which have the important strength of aggregating all Americans' individuals stories and assessing our challenges with the benefit of that information.

So that said, first, while I will reiterate that we face challenges, I think the evidence indicates the American middle class is actually healthier economically than many of us believe, but what it really needs is for strong economic growth to return.

A few statistics. The median household income of Americans, the income that's in the very middle of the distribution, for Americans under age 60 rose by 30 percent between 1979 and 2007, before taking into account public transfer payments, employer-provided health coverage, or the impact of taxes. After accounting for them, median income rose nearly $22,000 for a family of four between these two business cycle peaks.

It is true that this rate of growth pales in comparison with those of the 1950s and 1960s. Many observers, including President Obama, have attributed this slowdown to rising income concentration, which is said to have produced gains at the top at the expense of the poor and the middle class.

However, median incomes began to slow in the 1970s while income concentration did not take off until the 1980s. The middle class experienced strong income gains in the second half of the 1990s despite rising income concentration, and at the time you did not see inequality as a major political issue, interestingly enough.

Given the healthy state of the middle class, it is not only necessary but reasonable to implement reforms to senior entitlements so that we contain future deficits and debt levels that threaten America's economic stability and growth. Doing so will allow us to afford current and new commitments to promote the upward mobility of poor children, which will also increase productivity and growth in the long run.

Other policies to promote growth might include cuts in corporate and individual investment taxes; increases in Federal research-and-development spending, both of which might be expected to pay for themselves; greater high-skilled immigration; and health care reform, both as part of deficit reduction (because scheduled provider cuts are unlikely to be implemented) and to prevent the excessive health care inflation that the ACA's subsidies and mandated benefits are likely to create.

Second, the experience of the 1990s shows that work-based welfare reforms can ensure that low-income Americans also benefit from growth. Indicators that remedy the well-known flaws of the official poverty measure show that poverty has declined since 1979, with a particularly large drop between 1993 and 2000. This was the strongest period of income growth since the 1960s and reiterates the importance of robust economic growth for reducing poverty.

However, research suggests that child poverty would not have fallen as much during these years if not for Federal taxes and transfers. Since the safety net for non-working families actually became less generous during these years while it became more generous for working families, the implication is that the work-oriented welfare reforms of the 1990s helped to reduce poverty by encouraging low-income adults to enter the workforce.

Welfare reform was successful by replacing a program with minimal reciprocal expectations of recipients and severe work disincentives with a social policy regime in which work clearly paid off. Yet many of our safety net policies still ask little of beneficiaries and retain high marginal tax rates. For most people, as we have heard, I think, from some of the other folks who have testified, these programs serve as a temporary stopgap measure in hard times; but for others, especially during economic expansions, they end up becoming poverty traps, discouraging work, marriage, and saving. The problem is not so much one of personal failure but that people are responding to the incentives embedded in our safety net policies as any of us would in the same situation.

Third, while we have reduced poverty, Federal programs have failed to increase upward mobility out of the bottom, which remains stubbornly low. Despite rising inequality—I think this is an important point to make—the academic literature consistently finds that intergenerational mobility has not fallen since the mid-20th century. The American dream has not died. But, of course, it has not increased either, and only 30 percent of today's adults who are raised in the bottom fifth manage to make it into the middle fifth or higher as adults. This is a rate of upward mobility that should satisfy no one.

Winning a war on immobility, I believe, will require not only economic growth and safety net reforms, but that we empower poor parents to invest in the skills of their children. But soft-hearted policies must also be hard-headed ones. Given the dearth of successfully scaled-up models, we will have to discover how to increase the school readiness of poor children and keep them on track.

A system of opportunity grants for low-income parents would make markets for child investment services, uncover successful models, facilitate the dismantling of ineffective ones, and potentially raise parental aspirations in communities with deficits of hope for their children.

Thank you.

[The prepared statement of Mr. Winship follows:]

**"A Long-Run Perspective on Our Economic Challenges"**

**Testimony before the Committee on the Budget, U.S. Senate, Washington, D.C.**
**February 25, 2014**

Scott Winship[1]
Walter B. Wriston Fellow, Manhattan Institute for Policy Research

Chairman Murray, Ranking Member Sessions, and Members of the Committee, thank you for inviting me to appear today to discuss the outlook for the nation's economy and budget. As we enter budget season, with the Great Recession growing dimmer in our rearview mirror but significant economic anxiety riding shotgun, it is important to assess where we have been and where we stand—to carefully distinguish between short- and long-run challenges and to prioritize among them. I believe that our ability to do so is hindered by misconceptions about how the middle class and poor are doing and why. Below I discuss, in turn, long run trends in the living standards of the middle class, income inequality, poverty, and economic mobility. I then turn to the policy implications of these trends in the last part of my testimony.

**The Middle Class**

In order to effectively address the nation's economic and budgetary challenges, it is vital to maintain a proper perspective toward them. Unfortunately, much of our public discourse is rooted in assumptions that are either ill-founded or simply wrong. These assumptions defy simple ideological characterization.

For example, George Mason University economist Tyler Cowen recently asserted that, "the income for the median or typical household has risen only slightly since 1973."[2] That is simply untrue. The median household income of Americans under age 60, for instance, rose by 30 percent between 1979 and 2007 before taking into account public transfer payments, employer-provided health coverage, or the impact of taxes. It rose by 41 percent after accounting for them.[3] That translates into an increase of nearly $22,000 for a family of four between these two business cycle peaks.

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[1] The views expressed in this testimony are those of the author alone and do not necessarily represent the views of the Manhattan Institute.

[2] Tyler Cowen (2014). "'GDP: A Brief But Affectionate History' by Diane Coyle and 'The Leading Indicators: A Short History of the Numbers That Rule Our World' by Zachary Karabell," *Washington Post*, February 21.

[3] These figures are from my analyses of the Census Bureau's, Current Population Survey (CPS). Incomes are adjusted for household size by dividing by the square root of the number of occupants, a standard adjustment to account for the fact that smaller households need less than larger ones. The post-tax and -transfer estimates incorporate public cash and noncash transfers, including Medicare and Medicaid, and employer-provided health benefits, as well as federal and state income taxes (before credits), the Earned Income Tax Credit, payroll taxes, and property taxes. They do not include capital gains. I adjust incomes for inflation using the Bureau of Economic

This boost in incomes has occurred primarily because of earnings gains among women. Median hourly and annual compensation among men have not fallen, though they probably rose by no more than 10 percent between 1979 and 2007.[4] Productivity growth has been much higher over this period, which many have taken to indicate that male compensation should have grown more than it did. But we lack evidence about whether the productivity of the median male worker has increased; it could very well be that productivity has risen primarily among higher-skilled workers or those in top positions (or among women, for whom median annual and hourly compensation rose 73 and 48 percent, respectively).[5]

Furthermore, pay in 1979 was probably higher among men than productivity levels justified. Hourly compensation growth actually outpaced productivity growth in the nonfarm business sector between 1940 and 1970, especially from 1940 to 1947. By 1979, hourly compensation was still significantly higher than productivity growth since 1940 would have dictated.[6]

If pay was well-calibrated to productivity in 1940 (or higher than justified by productivity), then 1970 compensation was due for a correction. That interpretation is consistent with the fall in labor's share of income that we have seen since then as well as the rise in income concentration since 1980. It would also explain the slowdown in male pay, since men were two-thirds of the fulltime workforce in 1970 and more concentrated than women in relatively high-paying jobs such as those in manufacturing.[7]

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Analysis's "Personal Consumption Expenditures" deflator, the same index preferred by the Congressional Budget Office and the Federal Reserve Board.

[4] Analysis of the CPS, focusing on men between the ages of 25 and 59. "Compensation" includes earnings from wages and salary and from self-employment (including farming), as well as the value of employer provided health insurance. The median annual compensation among all such men increased by six percent from 1979 to 2007 and fell by four percent from 2007 to 2012. If I account for the increase in men who are sick or disabled or for men who could not find work by adding them in as below-median earners, the increase from 1979 to 2007 was five percent and the decline from 2007 to 2012 was eight percent. If I focus on only non-Hispanics to account for rising immigration, the increase from 1979 to 2007 was 13 percent and the decline from 2007 to 2012 was six percent. The median for non-Hispanic men after accounting for the increase in the jobless was nine percent from 1979 to 2007, and the decline from 2007 to 2012 was seven percent. For hourly compensation, I divide compensation by the usual hours worked in the previous year, as reported by respondents who worked. The median among all such men increased by seven percent from 1979 to 2007 and fell by two percent from 2007 to 2012. Adding in the nonworking men as below-median earners, the increase from 1979 to 2007 was four percent and the decline from 2007 to 2012 was five percent. Among non-Hispanics, the increase from 1979 to 2007 was 12 percent and the decline from 2007 to 2012 was two percent. The median for non-Hispanic men after accounting for the increase in the jobless was nine percent from 1979 to 2007, and the decline from 2007 to 2012 was four percent.

[5] The annual and hourly compensation increases for women are again from the CPS. Estimates for non-Hispanics or adjusting for jobless women do not change the conclusions substantively.

[6] Estimates are from the Federal Reserve Bank of St. Louis's "Federal Reserve Economic Data" (FRED) data archive. I compare the series on the nominal gross value added of the nonfarm business sector (Series A3S8RC1A027NBEA) to the series on nominal employee compensation in the nonfarm business sector (Series C4091C0A144NBEA and A4091C0A144NBEA). Since dividing the former by hours worked in the sector gives sector productivity while dividing the latter by hours worked gives hourly compensation, one can assess the relative growth rates of productivity and hourly compensation using these estimates.

[7] Bureau of Labor Statistics estimates of workers usually employed 35 hours or more from http://bls.gov/cps/.

One indication that the pay of male workers in 1940 was already higher than productivity levels justified is the widespread belief at the time that a single male breadwinner should have been able to support a family on his own paycheck. Since there is no reason to believe that the value added by a worker in the production process should necessarily have been an amount high enough to support a family single-handedly, the single-breadwinner ideal likely propped up male wages artificially for decades.

Over time, families became affluent enough to afford paid childcare and to purchase labor-saving appliances and processed foods. As women increasingly became dissatisfied with the homemaker role, more wives and mothers entered the workforce and worked longer hours. There was no justification for paying both husband and wife enough to raise a family single-handedly, and global competition made such overpayment that much less practical for businesses. The single-breadwinner ideal crumbled. Its collapse contributed to the subsequent stagnation in male wage growth.

That should not obscure the real household income growth experienced by the middle class in recent decades. Presumably, few families of four are indifferent between going back to 1979 living standards and having today's additional $22,000. It is true that there have been costs associated with sending two workers into the labor force, such as greater child care expenses. But it is also necessary to credit the gains experienced by women who have a degree of economic freedom denied them in generations past.

**Income Inequality**

While median income growth has been substantial in recent decades, it pales in comparison with the growth rates of the 1950s and 1960s. Many observers, including President Obama, have attributed this slowdown to rising income concentration, which is said to have produced gains at the top at the expense of the poor and middle class. It is certainly possible that the demise of the single-breadwinner ideal has led to disproportionate income gains at the top in recent decades. If the years since 1970 have seen an adjustment to recalibrate pay and productivity, we would expect that income gains prior to 1970 were stronger for the median household than at the top, greater at the top since then, but similar between the middle and top since 1940.

While the data is not ideal, the pattern it shows is broadly consistent with the idea of recalibration. I estimate that the household income of the middle fifth of Americans increased by 151 percent from 1940 to 1969 but by 66 percent from 1969 to 2007. The increase over the whole period was 317 percent.[8]

[8] For 1940 to 1969, I take the annual growth rate of family income from 1948 to 1969 from Economic Policy Institute tabulations of data from the Census Bureau's Current Population Survey. I then apply that growth rate to the 29 years between 1940 and 1969, assuming that the 1940-48 growth rate was the same. Since these are the years in which hourly compensation outpaced productivity, this is probably a conservative estimate of growth during this period. The figures are for the family income of families (rather than the household income of individuals). Household income data only go back to 1967, and while family income growth was probably stronger than household income growth from 1948 to 1969, using the former as a proxy for the latter is unlikely to distort the basic trend. "Income" includes cash transfer income from federal programs (such as Social Security, Unemployment Insurance, Supplemental Security Income, and Temporary Assistance for Needy Families) but does not include non-cash benefits from employers or government (such as health insurance, food stamps, or housing subsidies). These sources of income were relatively unimportant prior to the 1970s; Medicare and Medicaid were

Measuring top incomes is difficult due to a number of methodological and data issues. At the upper reaches of the income distribution, it can be difficult to determine the extent to which changes are real or simply responses to tax incentives, and these problems are much more pronounced for investment and business income than for earnings. Focusing on the earnings of the top five percent of tax returns, the increase from 1940 to 1969 was 77 percent, while from 1969 to 2007 it was 158 percent. Over the entire period, earnings income in the top five percent rose 357 percent—not much more than the increase in the median American's household income.[9]

Rising inequality, however cannot be the only explanation for the slowdown in household income growth. In the 1970s, household incomes increased only modestly throughout the income distribution—even at the top. That is to say, the growth slowdown predated the rise in income concentration. The primary cause is no mystery; productivity growth has slowed since the 1960s in industrialized countries around the world, and income growth has diminished accordingly.

It is also worth noting that because of the difficulties in measuring top incomes, the growth in and extent of income concentration has probably been overstated by the most widely cited estimates of

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enacted in 1965 and the food stamp program expanded nationally only in the early 1970s. Incomes are measured before taxes. See Economic Policy Institute (2012). "Mean family income, by income group" [data table]. The State of Working America. Washington, D.C.: Economic Policy Institute. http://www.epi.org/files/2012/data-swa/income-data/Mean%20family%20income,%20by%20income%20group.xlsx. The EPI income figures were adjusted back to nominal dollars and then inflated using the Bureau of Economic Analysis Personal Consumption Expenditures deflator for consistency with the other estimates.

For 1969 to 2007, the estimates are my own, using the Current Population Survey microdata. The figures are for the household income of households (rather than the family income of families or the household income of individuals). Since households became smaller over time as marriage and fertility declined and more people chose to live independently, I adjust income for household size. From 1979 forward it is possible to make other improvements. I add to income noncash federal benefits. Because there are two different ways of valuing Medicaid and Medicare, which produce very different growth estimates for the bottom fifth, I average across the two approaches for each year before computing income growth. I also use estimates in the CPS data to account for federal and state income taxes (before credits, except that the Earned Income Tax Credit is included in 1989 and 2007), payroll taxes, and property taxes. As with the EPI estimates, capital gains are excluded from these figures. Following the Congressional Budget Office, I also drop households with negative incomes, because such households experienced business or investment losses and are likely to have considerable wealth from which to draw down. Some households with business losses that left them with low but non-negative incomes remain in the data.

[9] The Current Population Survey cannot be used to validly produce estimates of income growth for the richest Americans, so for estimates of top-five-percent earnings growth across the entire 1948-to-2007 period, the figures of Thomas Piketty and Emmanuel Saez are used. These estimates indicate the change in the mean earnings of "tax units" (essentially, tax returns, after accounting for a small number of non-filers) rather than of families, households, or individuals. Earnings are measured before taxes are deducted, and no employer benefits are included. See Thomas Piketty and Emmanuel Saez (2007). "Income and Wage Inequality in the United States, 1913-2002." In A.B. Atkinson and Thomas Piketty, eds., *Top Incomes Over the Twentieth Century: A Contrast Between European and English-Speaking Countries* (Oxford: Oxford University Press). Updated figures at http://elsa.berkeley.edu/~saez/TabFig2012prel.xls. I adjust their income figures back to nominal dollars and then inflate them using the Bureau of Economic Analysis Personal Consumption Expenditures deflator.

Thomas Piketty and Emmanuel Saez.[10] Those estimates do not represent households or individuals per se, but "tax units," which are essentially tax returns. An unmarried student with a summer job who files a tax return is a tax unit, as are a 30-year-old living with a roommate and a 50-year-old married couple. The Piketty-Saez estimates take no account of any redistribution that occurs via public transfers or taxes and do not factor in the value of employer-provided health insurance. They do not count capital gains unless they are realized and reported on tax returns. That misses the vast majority of gains middle-class families receive from selling a home. Where gains are reported, the Piketty-Saez estimates count all the gains that have accrued from holding an asset in the year that those gains are realized. Finally, changes in the tax treatment of business income and stock options also likely overstate the rise in income concentration.

While their most-cited estimates indicate that the top one percent's income share rose from 10 percent in 1979 to 24 percent in 1979, the Piketty and Saez estimates for earnings rose only from 6 percent to 12 percent. Between 1989 and 2007, the increase was just from 9 percent to 12 percent.[11] In a recent paper that attempted to address many of the shortcomings of the Piketty-Saez estimates—in particular the treatment of capital gains—Richard Burkhauser and two of his students found that income concentration actually fell between 1989 and 2007.[12] This paper is not the final word on the matter, but it demonstrates that the most-cited figures on income concentration may have serious flaws.

**Poverty**

What about low-income households and workers? The 20th percentile of household income is the income that is higher than in 20 percent of households but lower than in 80 percent of them. If we use the 20th percentile to look at the income of poor non-elderly Americans, it rose by 28 percent between 1979 and 2007 and was flat between 2007 and 2012.[13]

Because of the large influx of immigrants with low educational attainment and limited English proficiency, the 20th percentile has been tugged downward over time as their share of the population has grown. While it is impossible to identify foreign-born persons in the data in 1979, among non-Hispanic Americans, the 20th percentile of household income rose by 36 percent from 1979 to 2012. That amounts to an increase of nearly $13,000 for a family of four.

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[10] Alan Reynolds (2006). *Income and Wealth* (Westport, CT: Greenwood).

[11] Thomas Piketty and Emmanuel Saez (2007). "Income and Wage Inequality in the United States, 1913-2002." In A.B. Atkinson and Thomas Piketty, eds., *Top Incomes Over the Twentieth Century: A Contrast Between European and English-Speaking Countries* (Oxford: Oxford University Press). Updated figures at http://elsa.berkeley.edu/~saez/TabFig2012prel.xls.

[12] Phillip Armour, Richard V. Burkhauser, and Jeff Larrimore (2013). "Levels and Trends in United States Income and Its Distribution A Crosswalk from Market Income Towards a Comprehensive Haig-Simons Income Approach." National Bureau of Economic Research Working Paper 19110.

[13] Once again, this is a size-adjusted post-tax and –transfer measure. See footnote 3.

While the official poverty measure used by the Census Bureau shows little change in poverty among nonelderly Americans, it has several well-known flaws.[14] Efforts to improve on the official measure support the conclusion that low-income Americans enjoyed higher living standards in 2012 than in 1979.[15] The years between 1993 and 2000 saw the most dramatic improvement, especially among children. This was the strongest period of income growth since the 1960s and reiterates the importance of robust economic growth for reducing poverty. However, research from a team of Columbia University poverty experts suggests that child poverty would not have fallen as much during these years if not for federal taxes and transfers.[16] That suggests that the work-oriented welfare reforms of the 1990s helped to reduce poverty by encouraging low-income adults to enter the workforce.

The safety net for non-working families became less generous during these years even as it became more generous for working families. The New Deal-era Aid to Families with Dependent Children program was replaced by Temporary Assistance to Needy Families through landmark 1996 legislation, but for years before that states had been experimenting with welfare reforms through the expanded use of federal waivers under Presidents George H. W. Bush and Bill Clinton. After 1996, cash assistance was block-granted and time-limited, and work and job-search requirements were mandated. Teen mothers were required to live at home and to receive education or training to receive benefits, and states could cap the number of children who were eligible for benefits.

However, welfare reform during the 1990s included generous carrots as well as sticks in attempting to move low-income adults into work. In particular, the Earned Income Tax Credit was expanded, child care subsidies increased, and it became easier to keep health insurance benefits upon taking work, reducing the marginal tax rates faced by the non-working poor when they entered the job market.

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[14] To determine if someone is poor, the Census Bureau counts income received from private sources or from government employment and adds federal benefits if they take the form of a check—so-called "cash transfers" like the Temporary Assistance for Needy Families and Supplemental Security Income programs for poor families, Unemployment Insurance for the jobless, and Social Security for senior citizens. It compares a person's family income—or their own income if they do not live with relatives—to a poverty line that varies depending on family size and the age of its head. The original poverty line was constructed in the mid-1960s and has been updated annually to reflect increases in the cost of living. While it was originally based in real-world analyses of what families needed to get by, it is best thought of today as an arbitrary but relatively low level of material well-being meant to be held constant over time.

The official measure does not count employer-provided benefits as income, and it does not count non-cash benefits from the federal government, such as Medicare, Medicaid, food stamps, or housing subsidies. Nor does it deduct taxes from income, which means that if the tax burden falls or the value of benefits provided through the tax code increases, improvement in living standards will be understated. But perhaps most importantly, because the official poverty line is adjusted for the cost of living every year by a measure, the "CPI-U," that is known to overstate inflation, it represents a higher living standard than it used to, making the change in poverty look too dour.

[15] Christopher Wimer, Liana Fox, Irv Garfinkel, Neeraj Kaushal, and Jane Waldfogel (2013). "Trends in Poverty with an Anchored Supplemental Poverty Measure." Working Paper. Available at http://socialwork.columbia.edu/sites/default/files/file_manager/pdfs/News/Anchored%20SPM.December7.pdf.

[16] Ibid.

One reason to think that it was the shift to work promotion that lowered child poverty rather than traditional expectations-free safety net programs is that the Columbia research indicates that subtracting out federal benefits and looking at pretax income does not alter the trend in child poverty much prior to the 1990s. Furthermore, in research I conducted with Harvard sociologist Christopher Jencks, we found that the 1990s expansion differed from those of the 1960s, 1970s, and 1980s in that the poverty rate for families headed by a single mother fell by more than it did among two-parent families.[17]

This story of declining child poverty merits two caveats. First, the traditional safety net probably did prevent child poverty from rising in recent years, starting with the 2000 recession and continuing through 2012. The Columbia figures indicate that poverty among children would have begun rising if not for federal benefits and the impact of tax policy. Instead, it fell a little more. Our federal safety nets should promote work, but we must be prepared to assist those who cannot find work, a delicate balancing act.

Second, liberal welfare rules may have contributed to the increase in single motherhood over time and even to the decline of work participation rates among less-skilled men. The evidence for such effects is weak, but the questions are difficult to answer convincingly. Whether welfare reform was a major factor behind the dramatic drop in teen pregnancy during and after the 1990s is an under-studied research question. One study found that welfare reform in the 1990s reduced teenage motherhood among the daughters of single or less-educated parents and encouraged them to live with a spouse or parent if they did become mothers.[18]

While the living standards of the poor have improved, the story is again less sunny for male earnings. Among working men, annual and hourly compensation at the 20th percentile were more or less flat from 1979 to 2007, though they rose by six or seven percent among non-Hispanic men. Annual compensation at the 20th percentile was about 6 percent lower in 2012 than in 1979 among non-Hispanic men.

Compounding these anemic earnings trends among workers, labor force participation among men in the bottom fifth of household incomes also fell. In 1979, 81 percent of adult men in the bottom fifth had earnings, which was already well below the 96 percent among adult men outside the bottom fifth. By 2007, however, just 72 percent of adult men in the bottom fifth of household income worked, compared with a still-strong 92 percent in the top four fifths.

Meanwhile, among women at the 20th percentile, there were strong increases in compensation. Between 1979 and 2012, annual compensation grew 134 percent, or about $10,000. That reflects an increase in hourly compensation of one-third, combined with a large increase in the number of hours worked. Nevertheless, just 55 percent of adult women in the bottom fifth of household income worked in 2007, up only from 51 percent in 1979. Among women in the top four fifths, the increase was from 70 percent to 82 percent.

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[17] Scott Winship and Christopher Jencks (2004). "How Did the Social Policy Changes of the 1990s Affect Material Hardship among Single Mothers? Evidence from the CPS Food Security Supplement." Harvard University, John F. Kennedy School of Government Faculty Research Working Paper Series, No. RWP04-027. Available at https://research.hks.harvard.edu/publications/getFile.aspx?Id=127.

[18] Robert Kaestner, Sanders Korenman, and June O'Neill (2002). "Has Welfare Reform Changed Teenage Behavior?" *Journal of Policy Analysis and Management* 22:225-248.

**Economic Mobility**

The belief that the American Dream has died and that intergenerational mobility has declined is widespread across the ideological spectrum. Nevertheless, a sizable academic literature consistently fails to find significant declines in mobility since the mid-twentieth century. The most common finding is a change so modest as to be statistically indistinguishable from no change at all.[19] Earlier this year, Harvard economist Raj Chetty and a team of researchers confirmed this consensus with a paper finding that children born in 1993 likely had experienced the same mobility as those born in 1971.[20] In my own forthcoming research, I find that today's thirty year olds—who experienced rising income inequality between the middle class and poor during early childhood and have witnessed rising income concentration at the top through their entire lives—have experienced no more and no less mobility than did thirty year olds in the mid-1970s.[21]

Many find it difficult to believe that mobility has not declined given that inequality has increased, but we exaggerate the importance for mobility of how much one's parents—or someone else's parents—make. The link between income inequality and mobility has been greatly overstated, as I have argued elsewhere.[22]

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[19] Robert T. Reville (1996). "Two Essays on Intergenerational Earnings and Wage Mobility." Doctoral Dissertation, Brown University.; Mary Corcoran (2001). "Mobility, Persistence, and the Consequences of Poverty for Children: Child and Adult Outcomes." In Sheldon H. Danziger and Robert H. Haveman, eds. *Understanding Poverty* (New York and Cambridge, MA: Russell Sage Foundation and Harvard University Press).; David I. Levine and Bhashkar Mazumder (2002). "Choosing the Right Parents: Changes in the Intergenerational Transmission of Inequality—Between 1980 and the Early 1990s." Federal Reserve Bank of Chicago Working Paper 2002-08. Available at http://www.chicagofed.org/digital_assets/publications/working_papers/2002/wp2002-08.pdf.; Angela R. Fertig (2003). "Trends in Intergenerational Earnings Mobility in the United States." *Journal of Income Distribution* 12: 108-130.; Yunju Nam (2004). "Is America Becoming More Equal for Children? Changes in the Intergenerational Transmission of Low- and High-Income Status." *Social Science Research* 33: 187-205.; Susan E. Mayer and Leonard M. Lopoo (2005). "Has the Intergenerational Transmission of Economic Status Changed?" *Journal of Human Resources* 40(1): 169-185.; David J. Harding, Christopher Jencks, Leonard M. Lopoo, and Susan E. Mayer (2005). "The Changing Effect of Family Background on the Incomes of American Adults." In Samuel Bowles, Herbert Gintis, and Melissa Osbourne Groves, eds. *Unequal Chances: Family Background and Economic Success* (New York and Princeton, NJ: Russell Sage Foundation and Princeton University Press).; Tom Hertz (2007). "Trends in the Intergenerational Elasticity of Family Income in the United States." *Industrial Relations* 46(1): 22-50.; Chul-In Lee and Gary Solon (2009). "Trends in Intergenerational Income Mobility." *Review of Economics and Statistics* 91(4): 766-772; and Deirdre Bloome and Bruce Western (2011). "Cohort Change and Racial Differences in Educational and Income Mobility." *Social Forces* 90(2): 375-395.

[20] Raj Chetty, Nathaniel Hendren, Patrick Kline, Emmanuel Saez, and Nicholas Turner (2014). "Is the United States Still a Land of Opportunity? Recent Trends in Intergenerational Mobility," NBER Working Paper No. 19844. (Cambridge, MA: National Bureau of Economic Research). Available at http://obs.rc.fas.harvard.edu/chetty/mobility_trends.pdf.

[21] Scott Winship (forthcoming). "The Dream Abides: Economic Mobility in America from the Golden Age to the Great Recession."

[22] Scott Winship (2013). "Overstating the Costs of Inequality." *National Affairs* 15. Available at http://www.brookings.edu/~/media/research/files/articles/2013/03/overstating%20inequality%20costs%20winshi

But the fact that mobility has not fallen should provide little comfort given how limited upward mobility remains. Only thirty percent of today's adults who were raised in the bottom fifth of household incomes managed to make it into the middle fifth or higher.[23]

**Economic and Fiscal Policies to Help Poor and Middle Class Americans**

This review of long-term trends in household income, earnings, inequality, and mobility points to three conclusions for policy.

*1. The American middle class is economically healthy, it just needs for strong economic growth to return. Robust economic growth would also be the single most beneficial influence on the living standards of the poor.*

Since the fortunes of poor, middle class, and rich Americans tend to rise and fall together, and because no one has established a compelling case that rising income concentration has hurt anyone, efforts to diminish income concentration distract from the more important task of achieving broad income growth. Both the poor and middle class experienced strong income gains in the second half of the 1990s, despite rising income concentration, and the pay of women has increased notably even as income concentration has risen. A recent Brookings Institution study found that some of the cities with the most economic vitality have the highest inequality levels.[24]

To the extent that rising income concentration has come at the expense of the poor and middle class, it likely represents the result of "front-loading" long-term benefits of productivity growth in the 1940s, 1950s, and 1960s to support a gendered division of labor that most families have rejected in favor of greater affluence and personal fulfillment. If the benefits of productivity growth since 1940 had been smoothly realized between then and now, workers would today have earnings levels that match our actual ones very closely. But rather than a "Golden Age" followed by "stagnation", we would have experienced steady growth.

Successfully reducing the growth of income inequality might have unintended consequences, such as reducing economic growth. It is even possible that such an effect would be big enough to leave the poor and middle class with bigger pieces of a smaller pie, such that no one is any better off in absolute terms (despite the rich being worse off).

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p/overstating%20inequality%20costs%20winship.pdf. Scott Winship and Donald Schneider (2013). "The Great Gatsby Curve Revisited: Part 1, Does More Inequality Correspond with Less Economic Mobility Across Local Job Markets?" http://www.economics21.org/commentary/great-gastby-curve-revisited-part-1. Scott Winship and Donald Schneider (2014). "The Great Gatsby Curve Revisited: Part 2, Collapse of the Great Gatsby Curve," http://economics21.org/research/collapse-great-gatsby-curve

[23] Pew Economic Mobility Project (2012). "Pursuing the American Dream: Economic Mobility Across Generations." Available at http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pursuing_American_Dream.pdf.

[24] Annie Lowrey (2014). "Study Finds Greater Income Inequality in Nation's Thriving Cities," *New York Times*, New York edition, p. B3. February 20, 2014. Available at http://www.nytimes.com/2014/02/20/business/economy/study-finds-greater-income-inequality-in-nations-thriving-cities.html?_r=0.

Given the healthy state of the middle class, it is not only necessary but reasonable to implement reforms to senior entitlements so that we can tame future deficits and debt levels that threaten America's economic stability and growth. Doing so will also allow us to afford new commitments to promote the upward mobility of poor children, which will also increase productivity and growth in the long run. Absent such reforms, there will be no room in the federal budget for even our current commitments.

Other policies to promote economic growth might include:[25]

- Pairing cuts in corporate and individual investment taxes to encourage job creation with increases in federal research-and-development spending to promote innovation. Both policies would be likely to pay for themselves down the road.
- Greater high-skilled immigration to increase the stock of human capital from which our economy can draw for innovative ideas and to ensure competitive labor markets among professionals.
- Health care reform, both as part of deficit reduction (because scheduled provider cuts are unlikely to be implemented) and to prevent the excessive health care inflation that Obamacare's subsidies and mandated benefits are likely to create.

*2. The experience of the 1990s shows that work-based welfare reforms can ensure that low-income Americans also benefit from growth.*

Safety-net reforms that encourage work can reduce poverty by fostering initiative and lowering marginal tax rates. Welfare reform was successful by replacing a program with minimal reciprocal expectations of recipients and severe work disincentives with a social policy regime in which work clearly paid off. Yet, many of our safety-net policies still ask little of beneficiaries and retain high marginal tax rates. For most people, they serve as a temporary stopgap measure in hard times, but for others, especially during economic expansions, they become poverty traps, discouraging work, marriage, and saving. As Charles Murray long ago argued, the problem is not so much one of personal failure but that people are responding to the incentives embedded in our safety-net policies as any of us would in the same situation.

Two ideas that address the work disincentives of our sprawling and uncoordinated safety net regime have recently been offered. Oren Cass, former domestic-policy director of Mitt Romney's 2012 presidential campaign, has proposed block-granting our means-tested programs and sending them to the states as a "flex fund". The flex fund would be coupled with an expansion and reconfiguration of the work subsidies currently offered through the Earned Income Tax Credit. Senator Marco Rubio is developing a proposal along these lines, which would have the benefit of encouraging policy experimentation at the state level while increasing the incentives to work among those whose wage prospects are modest.

Relatedly, Congressman Paul Ryan, Chairman Murray's counterpart in the House, has spoken sympathetically toward the United Kingdom's new Universal Credit program. The Universal Credit packages a number of scattered safety-net programs together and delivers a simplified benefit to those who qualify. Most importantly, it is carefully designed so that the size of the credit tapers as earnings

[25] Scott Winship (2014). "Actually, We Won the War on Poverty." *Politico Magazine*. Available at http://www.politico.com/magazine/story/2014/01/war-on-poverty-conservatives-102548_full.html.

become a bigger share of household income, but in such a way as to encourage beneficiaries to work more.

These are encouraging generalizations of the 1990s welfare reform. It is worth highlighting two issues regarding work-promoting safety net reforms, however. First, while the 1990s reforms clearly reduced poverty, we lack the evidence so far—because the 1990s were not that long ago—that they increased upward mobility. If, as I have argued, more money is not enough to expand mobility, then safety net reforms may have the biggest impact on child mobility to the extent that they affect the aspirations, values, and family lives of poor children and their parents.

The decline in teen pregnancy offers a possible hint that safety-net reforms can affect behavior in a way that might promote upward mobility. In addition to promoting work through the tax code or a universal credit, it may be desirable to promote marital childbearing as well. Out of wedlock childbearing has increased markedly, and I believe we are approaching the problem from the wrong perspective. Though research overwhelmingly suggests that children who grow up with a single parent tend to have poor outcomes, it does not establish that the children would typically have done any better if their parents—their specific parents, not generalized parents with some other set of skills, values, and assets—had married or stayed married. Anyone who has seen MTV's "Sixteen and Pregnant" and the complicated lives of the show's protagonists ought to recognize that the children born to these couples have a lot working against their success regardless of whether their parents marry or not.

However, even if it were the case that the children born to single mothers face long odds regardless of their parents' marital status, by encouraging young men and women to delay childbearing until they are in a better place, policies might have an important impact on mobility rates. In that case, we would not be improving the opportunities of children in disrupted families by encouraging their parents to stay together. Instead, we would be improving child opportunities by preventing children from being born into disrupted families and encouraging childbearing among those same men and women when their lives are more conducive to successfully raising a child. Just as a work supplement can send a clear signal about the rewards for behaving in opportunity-enhancing ways, so too a married-parent credit could affect thinking at the margins when young men and women contemplate their birth timing.

A second issue related to work-based safety-net reforms is that we will always need a safety net to catch those who cannot secure stable employment. The overlap between children with low mobility prospects and children whose parents will struggle to find and keep work is likely to be substantial. One easy way to minimize the number of people who fall through the cracks is to build a counter-cyclical element into any block-grant or universal credit regime, so that the system can respond appropriately in downturns as unemployment worsens.

*3. While we have reduced poverty, in part through the fifty-year war we have waged since Lyndon Johnson declared it our combatant, federal programs have failed to increase upward mobility out of the bottom, which remains stubbornly low.* [26]

Encouraging economic growth will not help those parents with the worst jobs keep their kids from filling those bad jobs someday themselves. Welfare reforms may expand child opportunity, but only indirectly, and they may only reduce poverty without actually nudging mobility. Winning a war on immobility, I

[26] This discussion is drawn from my recent essay for *Politico Magazine* (op. cited), with permission.

believe, will require a program to help poor parents invest in their young children. If parents are unable to ensure their children's school-readiness and keep them on track academically, the federal government can empower them to find the help they need.

The problem is that we have astonishingly few early- and middle-childhood models that have been shown to work on a large scale. But we should nevertheless commit substantial resources to discovering successful models, even as we also commit to shuttering existing programs that have not proved effective. A system of opportunity grants for poor children would allow low-income parents to pay qualifying providers for any of a range of eligible child investment services—after-school programs, tutoring, summer enrichment programs or other strategies. Providers would have to agree to be evaluated, and consistently ineffective providers—and approaches—would be excluded from receiving grants as the evidence comes in.

This approach would be "market making" in the sense that it would incentivize the supply of child investment services and encourage parents to seek them out. Ideally, the circulation of opportunity grants in low-income communities would inspire competition among parents to ensure they are doing right by their children, potentially altering community norms and aspirations. To be sure, many—probably most—models initially would be revealed to be ineffective, but that will build consensus about the limits of what social policy can do and about the need not to waste money on approaches that do not work. And such a program would discover workable models and seed successful ventures like the KIPP schools, becoming much more obviously cost-effective in time. If the opportunity grant program succeeds, it would open up the conversation around K-12 reform as well and point to a new federal role in education.

*4. We should not confuse short-term cyclical challenges for long-term structural ones.*

Too often, we forget that we have just lived through the worst economic downturn since the Great Depression. Remarkably, and thanks in no small measure to a federal safety net that caught those who needed it, incomes have essentially fully recovered.[27] This is in marked contrast to the painfully slow recovery from the Depression over the 1930s and early 1940s. Unemployment levels never approached those experienced during the Depression and were not qualitatively different than in the double-dip recession of the 1980s. We are well on our way to a healthy economy, and the long-term trends discussed here suggest that our economic challenges are real but manageable.

The unique challenge of this recovery has been the historically high likelihood that someone who is unemployed will be so for a long time. The extent to which the federal safety net has exacerbated this problem or mitigated the effects of it are much in dispute. But it is no longer 2009. Unemployment rates have been declining steadily, as have jobless rates that include discouraged workers.[28] Declines in labor force participation continue long-term trends that are poorly understood but that are affected by rising

[27] Scott Winship (2013). "What Has Happened to the Incomes of the Middle Class and Poor? Part 1." Available at http://www.economics21.org/commentary/what-has-happened-incomes-middle-class-and-poor-part-1.

[28] Scott Winship (2013). "Has Unemployment Fallen for the Wrong Reason?" Available at http://www.economics21.org/commentary/has-unemployment-fallen-wrong-reason.

school enrollment and the aging of the baby boomers.[29] To the extent that we have a labor force participation problem, reforming our welfare programs—this time our disability programs—is likely to be an important part of the solution.

Extending emergency unemployment insurance benefits in 2014 would undoubtedly help many Americans, just as the availability of disability benefits does. But making safety nets more generous also carries the risk that unintended consequences will create sizable costs. Extension of benefits would cause some to postpone looking for work, and by reducing labor supply, it would keep the cost of hiring elevated above what it would otherwise be, hurting labor demand more generally.[30] North Carolina's experience ending its emergency unemployment insurance program suggests that neither the benefits nor the costs of an extension are obviously greater than the other at this point in the recovery. It may be time to focus on long-term economic and budgetary issues.

It is also tempting, given the sluggish growth in wages and widespread economic insecurity, to attempt to reduce poverty by raising the minimum wage. Here again the obvious benefits may not exceed the less obvious costs. A forty percent increase in the minimum wage over three years to a level that would be unprecedented risks hurting demand for labor.[31] If the immediate economic challenge we face is long-term joblessness, it is unclear why we would want to raise the cost of hiring the most disadvantaged workers and risk exacerbating the problem.

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[29] Scott Winship (2012). "Misunderstanding Declines in Labor Force Participation." Available at http://www.realclearmarkets.com/articles/2012/09/12/misunderstanding_declines_in_labor_force_participation_99874.html.

[30] Marcus Hagedorn, Fatih Karahan, Iourii Manovskii, and Kurt Mitman (2013). "Unemployment Benefits and Unemployment in the Great Recession: The Role of Macro Effects." NBER Working Paper 19499. (Cambridge, MA: National Bureau of Economic Research)

[31] Scott Winship (2013). "How Solid is the Case for Raising the Minimum Wage?" Available at http://www.economics21.org/commentary/how-solid-case-raising-minimum-wage

Chairman MURRAY. Again, thank you to all of you for being here and your testimony today.

Ms. Johnson, let me begin with you. You talked in your testimony about how hard it is for Americans to get into and stay in the middle class. This really is an erosion of the American dream, as you talked about. You are a teacher. You are a mother. Every day you are surrounded by a lot of young people. What types of investments do you believe are most important to make sure that our young people, our country's future really, have a better shot at the American dream?

Ms. JOHNSON. Thank you, Chairwoman. I think we have to invest in job creation so that there is something—there is hope that they are going to have a job when they come out of school, whether they go to college or not. I think that is the most important thing. I have been very clear that I think that the creation of jobs in my community and my State is the number one, because when folks have jobs, when the parents of my students have jobs, when my students have the opportunity for good jobs, then everything is better in school. And that is the second thing I think we should invest in, is a reliable formula funding program for schools so that students like mine who largely live in poverty get what they need at school. So I would say jobs and public education.

Chairman MURRAY. All right. Thank you very much. And Senator Stabenow, who has got a manufacturing bill, is nodding over there. I can feel her.

Senator STABENOW. Yes, exactly.

Chairman MURRAY. Ms. Tanden, we got a report from the Congressional Budget Office last week, as you know, about the projected effects of raising the minimum wage on family income and employment. Can you talk a little bit about your thoughts on this report and the related research on the minimum wage?

Ms. TANDEN. Absolutely. I think a lot of people who have been looking at the research were really surprised by CBO's findings because there have been so many really large-scale recent efforts and reports and analysis of minimum wage as it is actually applied that have demonstrated that the minimum wage does not encourage job loss and might actually increase jobs. There are numerous Nobel laureates who have supported the minimum wage and have argued that a minimum wage increase will have no negative impact on jobs.

I would like to talk about one particular study that analyzed minimum wage increases among States, looked at States that increased the minimum wage and looked at States that did not, and it looked—really did a deep-dive analysis of the borders, the counties, and the borders between those two States, and it is one of the most comprehensive studies—it was done by professors at Berkley and Universit of Massachusetts at Amherst—and details how, in fact, when the minimum wage increased in communities, people had more money to spend, and they spent it in their communities, and there was no negative job attribution for that, and the jobs did not move from one county with a high minimum wage to a low-income county, although that would be relatively easy to do. And so they did not find the negative numbers, and it seems like CBO looked at recent studies and older studies and averaged the two, instead of looking at the most recent analysis. And that is why I think 600 economists have written in favor of a minimum wage increase. And I think we should recognize the arguments behind the minimum wage are really important economic arguments, because we have a demand challenge in this economy.

But at the end of the day, I think one of the most important issues here is whether people should work 40 hours a week, many of them parents, most of them women—two-thirds of minimym wage workers are women—and live in poverty. And I think in a country as great as ours, the answer to that question should be no.

Chairman MURRAY. Well, thank you, and with that, let me turn to Ms. Kimball. It is great that we have got two witnesses here who actually work in schools, so thank you both. What you are all doing is really important, and we appreciate it.

Ms. Kimball, let me talk to you. In your testimony, you did talk about the need to increase the minimum wage, which, we know, has not changed in 5 years. And I just wanted you to tell me what that increase in minimum wage would mean to your family and for others in your community. What types of things would you be able to buy or do then that you are not able to do today?

Ms. KIMBALL. It would mean for people in my community probably to encourage them to get a job if, you know, it is there. For my family, it would mean I could save for college for my children, put that money to possibly go on vacation, which we have never had, never been on vacation. It would just mean a better life, you know, overall for my family.

Chairman MURRAY. Okay. Thank you very much.

My time is up, and we do have votes coming up, so I am going to turn it over to Senator Sessions for his questions.

Senator SESSIONS. Thank you.

Ms. Johnson, you know, we spend about $100 billion, I think, on all the different education programs from the Federal Government. Of course, the States are the primary funders of education. But interest on our debt this year is expected to be $233 billion, and it is expected to increase to $870 billion in 10 years. So for those of us who are concerned about our future and our children's future, we have got to watch out that we do not put ourselves on a track to a fiscal crisis, as Dr. Elmendorf warned right from that table a couple of weeks ago, and put us in a position where interest—the fastest growing item in our budget—crowds out all other spending. I mean, $870 billion in 1 year of interest is well above the defense budget of 500, well above Medicare, around 500, well above Medicaid. So, anyway, that is one of the challenges that we have to face. We just have to be realistic about it.

Really, food stamps have not been cut, Ms. Tanden, to any significant degree. It went up four times from 2001 through 2011, four-fold, and this year's ag bill reduced welfare from 800—saved $800 billion out of—$8 billion out of $800 billion. That is how much the saving was over the projected growth of food stamps. So we made no real changes whatsoever and have not reduced that. And I just do not think we are evaluating that enough.

Now, Mr. Doar—well, first, I think we all agree, Ms. Johnson, that economic growth is important. Could I briefly, Dr. Winship, ask you just some simple questions. You have studied these issues.

Would more American energy strengthen economic growth and help create jobs?

Mr. WINSHIP. I would have to believe it would.

Senator SESSIONS. Are there regulations that are damaging the economy and businesses that could be eliminated and improve economic growth?

Mr. WINSHIP. I think there are for sure at all levels of Government.

Senator SESSIONS. Do you have an opinion as to whether or not the Affordable Care Act is adversely affecting job creation and economic growth?

Mr. WINSHIP. I think it has increased the amount of uncertainty that employers face in terms of their business plans. I think it has got incentives to hire part-time workers instead of full-time workers or reduce people to part-time work. So I think potentially it is a problem.

Senator SESSIONS. Two-thirds of the jobs last year created were part-time.

Higher taxes tend to retard economic growth, do they not?

Mr. WINSHIP. I believe that is right.

Senator SESSIONS. And the deficits themselves, the debt itself that we have today, is that, as someone said, a wet blanket or a depressant of economic growth and investment by the private sector?

Mr. WINSHIP. It is certainly not helping growth, I think. The lessons of the 1990s, I think, is that when you take dramatic steps to show that you are concerned about deficits and getting them under control—

Senator SESSIONS. All those things can be done without increasing debt and taxes and spending.

Mr. Doar, share with us your view—this vision here, something that I think is not impossible, but we are not close to it, I will acknowledge, right now. So we create a single Federal welfare assistance office. All our programs are there. When a person is in need, they go to that office, and they are identified and worked with individually.

I was with a lady who got 800 people jobs. She told us last week she spends as much as 18 hours with each unemployed person who comes in her office to focus them in the right way. Could we develop an individual plan for those people who are hurting and help them move into employment and prosperity?

Mr. DOAR. I think the programs could work much better together to support work and support—and provide assistance to working individuals so that they can go to work in jobs that may pay lower than is able for them to raise a family, but then you raise their total income by supports for working people as opposed to imposing a very, I think, blunt instrument that could end up losing jobs, especially for the most vulnerable part of our society.

I ran the poverty programs in New York City, and to some extent, the people that were most at the fringes of the labor force were African American men. And I have a very great concern that raising the minimum wage will affect them more negatively than positively. And I think Congress should be very careful about playing with labor markets in that way when we have a work support system that shores up low wages through the earned income tax credit and other supports that can go to working Americans.

Senator SESSIONS. Well, thank you. I know my time is up. Thank you very much, all of you.

Chairman MURRAY. Senator Stabenow.

Senator STABENOW. Thank you very much, Madam Chair, for this very important hearing, and thanks to each of you.

Just a couple of things for the record on numbers. I just want to emphasize again that the head of the Budget Office, when he testified, indicated to us that in 2008 the budget deficit was $1.4 trillion, and this year it is going to be 514, so $1.4 trillion to $514 billion and next year down to 480, as the Chair knows. So I just want to say it is going down. It has dramatically gone down. Unfortunately, we are not seeing employment go up, and we are never going to get totally out of debt with 10 million people out of work. So we should be focused on jobs and investments certainly in the future.

I also, just for the record, as Chair of the Agriculture Committee, want to indicate, in fact, we have built in savings to this 5-year farm bill, $11.5 billion, Madam Chair, we will spend in less food assistance dollars, the right way, which is people going back to work and they do not need temporary help. So $11.5 billion less because people are going back to work, and that is the way we ought to reduce these programs.

So a question that I have, I guess, to start, Mr. Doar and Dr. Winship, you have talked about people working to be able to get help. What do you say to Ms. Kimball and Ms. Johnson, who are working, what do you say to somebody who is working 40 hours, 50 hours, 60 hours, two, three jobs, and still in poverty? What do you say to them?

Mr. DOAR. Well, what we have talked about in New York is the extent to which work support programs can shore up wages that are not sufficient to rise people above the poverty level, so that is what has been successful, whether it is the earned income tax credit or food stamp benefits or public health insurance. And that is what I think Mr. Winship is talking about when he says the poverty measure does not really accurately measure the material well-being of families because it does not take into account all of the supports that Government provides.

Senator STABENOW. If I may just stop you there, just in the interest of time, what you are suggesting is that rather than raising the minimum wage so there is a decent livable wage, that Government, taxpayers, should be paying more money through their earned income tax credit or food help or Medicaid and so on. Certainly we are already doing that. That is what is happening to people on minimum wage. But, I just want to throw out a business owner who some years ago said that the minimum wage was not good enough and actually doubled it for his employees, and he was heavily criticized and shunned by the business community. People said he would go bankrupt. A hundred years later, we now call him one of our great business leaders, and he is Henry Ford. And he doubled his employees wages at the time, and when they said he was crazy, he said, "I need somebody who can buy my cars." And so, you know, how do juxtaposition that.

Mr. DOAR. Well, CBO did say that there would be job losses, as much as 500,000 to a million. And I think given the increased automation in the workplace and the not great health of labor markets in large parts of the country, an increased minimum wage is a very risky thing for allowing people into the workplace.

Senator STABENOW. So your position would be that rather than reward work so if someone is working 40 hours a week, so they they would be out of poverty, that they work 40 hours a week, they stay in poverty, but Government subsidizes that poverty?

Mr. DOAR. Well, if poverty is the definition of material well-being, the Government supports would make them not in poverty. And often that is what many people from both sides of the aisle say, the extent to which these Government programs rise people out of poverty by providing assistance.

So, again, from the perspective of the welfare office in New York City, this combination of work requirements and work expectations with work supports got people into the workforce in a very high degree and provided assistance that allowed them to be above the poverty line in terms of their entire material well-being.

Senator STABENOW. And I agree with you. I think we need to be doing more on work, job training, and similar efforts. We are seeing programs in Michigan that match up employers with individualized skill development for people through community colleges. Of course, that takes resources, which is the other issue, because, Mr. Doar, you are suggesting that we actually support people by increasing the earned income tax credit, which colleagues on the other side of the aisle want to cut, or they want to cut food assistance. That was the big debate in the farm bill. It was not doing more. It was actually to do less.

Mr. DOAR. Well, I thought it was more to get people more into work, as you said—

Senator STABENOW. No, not at all.

Mr. DOAR. Well, to the extent that their earnings were replacing the assistance provided and the savings was generated from that respect. And we are—I am not someone who shies away from Government spending that supports working individuals and gets more people working, because—

Senator STABENOW. I appreciate that, and I am going to stop in just one second because I want to—I do not mean to be rude, but, Dr. Winship, I am just about out of time.

Chairman MURRAY. And we do have votes that start at 15—

Senator STABENOW. And I am just going to say then, I will just make a comment, Madam Chair, rather than ask a question. But when you talk about how the middle class is better today, boy, that is not what I am hearing. And I just have to say for the record, I do not even see the numbers showing that when we see the top 10 percent of the public getting 76 percent of the wealth in 2010, and the bottom 60 percent of Americans, fell to less than 2 percent of the wealth. So I would sure love to see your numbers because, Madam Chair, that is certainly not what I see.

Chairman MURRAY. And we have to get our members to the vote, so I am going to go to Senator Johnson. Thank you.

Senator JOHNSON. Thank you, Madam Chair. And as long as we are talking about numbers, Ms. Tanden, you talked about cutting food stamps. I just want to reinforce what Senator Sessions said. In the year 2000, 17 million Americans were on food stamps. It cost about $17 billion. Last year, 47 million Americans, an increase of 30 million more Americans, were on food stamps, and it cost almost $80 billion. And I have the entire list here. I have never seen a cut in the program, so it has grown. So just, you know, to give us accurate information from that standpoint.

We share the same goal here. I mean, I agree with you, Ms. Tanden, that the question is: Are we expanding opportunity for all Americans? We want a prosperous America, and that is really what we have to talk about.

Mr. Doar, I want to just talk a little bit about, you know, the minimum wage and a potential loss of 500,000 jobs. Those are estimates, that is true. But you talked about the earned income tax credit. Isn't that a better way of addressing individuals, particularly heads of households, that are in low-wage jobs to rise them out of poverty without risking job loss?

Mr. DOAR. Yes, it is a better way; it is a more targeted way; it is a more effective way. And there are portions of the population, like single individuals without children, that we could do more to make them more a beneficiary of the EITC to help them get into the workplace.

Senator JOHNSON. Let me just throw out a couple more numbers. If we were to increase the minimum wage from $7.25 to $10.10, that would raise an annual salary about $6,000. We had an Inspector General's report about the earned income tax credit showing that between 21 to 25 percent of those payments were improper, costing about $11 billion per year. So if you take $11 billion divided by, let us say, the 900,000 people CBO estimates that increasing the minimum wage would increase—rise out of poverty, that would be about almost $13,000. I mean, if we would solve that improper payment problem, possibly eliminate the individual taxpayer identification number that leads to that fraud, couldn't we make the earned income tax credit a far more robust program—

Mr. DOAR. Yes, the program—

Senator JOHNSON. —and far more better job of raising people out of poverty without risking jobs?

Mr. DOAR. It is a good program, but it is not perfect and it needs fixing. And that is a major problem with the program.

Senator JOHNSON. We had an incredibly interesting witness last year in the Budget Committee right here in this room. He was the head of the welfare department in Pennsylvania, and he had done a study on a single mom who, again, we have got a great deal of sympathy for. We all want a strong social safety net to help people like that. But his study showed that beyond $26,000 of income, that young woman had no incentive—there was no marginal benefit because of an increase in taxes and reduction of benefits for her to earn $27,000 or $30,00 or $40,000 or $50,000 or $60,000. She would have to leapfrog to $60,000. Can you just speak to the disincentivizing nature of our social safety net?

Mr. DOAR. Well sometimes arguments are made about the marginal tax rates, and that would lead to greater benefits or slower phase-out periods further into the middle class. I have some concern about that for budget deficit reasons. So, sure, there is a conception that the loss of the assistance from Government will make someone less likely to move up the economic ladder or take a higher-paying job. But I have not been persuaded that that is so significant that we should extend assistance even further up the economic ladder.

Senator JOHNSON. I am not talking about the solution. I am just talking about the reality of the situation. You know, just like we heard CBO, because of the Obamacare subsidies, 2.5 million people will remove themselves from the labor force, which, Mr. Winship, let me ask you, that is not good for the economy, is it? Because you have to combine human capital with financial capital to make an economy grow, correct? Can you speak to that disincentivizing nature?

Mr. WINSHIP. Yes, I think that is right, and I think the problem with a lot of policies that look really attractive, like raising the minimum wage, is that the benefits to them are obvious and clear-cut for the people that get them. To the extent that somebody's wage goes up from $7.25 to $10.10, that is a clear benefit to them. The costs are much more diffuse, and so for the people who lose their job, or who never get hired because the cost of hiring has gone up so much, that is a real problem.

Senator JOHNSON. We always hear that raising the minimum wage increases demand. Who pays for that, though? And isn't that a business that pays it? And doesn't that decrease demand? I mean, aren't you taking money out of a business owner's pocket, which, you know, from my standpoint is going to probably reduce the number of jobs available, but also reduces that business person's purchasing power, does it not?

Mr. WINSHIP. Yeah, I think, I mean, the effects of increasing the wage in any given moment I think are really hard to predict. What we do know is that the major challenge of the Great Recession is long-term unemployment. That is the main way that this recession differed from past ones.

Arguably, what the CBO report found is that there is a cost of raising the minimum wage that results in less employment. The flip side of that is you could actually lower the minimum wage and increase employment, and then we could use work supports like Mr. Doar talked about if we worried about poverty increasing. So I think the earned income tax credit and those sorts of policies are just clearly better than a minimum wage hike.

Senator JOHNSON. Thank you, Madam Chair.

Chairman MURRAY. Thank you, Senator Johnson. And we have 4 minutes to get to a vote. I am going to let Senator Whitehouse have the last word. I cannot imagine somebody lowering the minimum wage from $15,000 a year and surviving, but I will let Senator Whitehouse—

Senator WHITEHOUSE. We do have very short time, so I just will ask my question for the record. But first I want to thank Ms. Kimball and Ms. Johnson for their testimony. You have no idea what a relentless diet of policy we get here, and that can get quite disconnected from personal life and personal experience, particularly when there is ideology and even perhaps special interests driving policy determinations. So hearing from you is really refreshing and really powerful, and I appreciate it.

I do want to say that when the economy gets trashed, because of the Great Recession, because Wall Street looted the economy, because of unbelievable tax favoritism in the Tax Code, and as a result of those very painful countrywide phenomena that we saw, families have to go on to food stamps in order to continue to eat and feed their children, to take a look at that and say that the problem is the food stamps to me is very much at odds with reality.

Let me ask the question, and I will ask—this is going to be a little bit unusual, but I would like to ask Ms. Tanden and Mr. Doar for the record, if you could get together and see if there are any joint recommendations that you could agree to, to address the benefit cliff question of when somebody gets right up to the edge and then they look at the next step they can take to help their family, and because of the benefit structure it actually worsens their family income. That is a dumb thing to have in a program. It is something we would like to avoid. If there are ways in which from both sides of the aisle we could get some guidance as to how best to address that, I think that would be a productive outcome for the hearing. So if you would be willing to have a conversation with each other and see if there is anywhere you agree and then get back to us for the record.

Chairman MURRAY. That would be great.

Senator WHITEHOUSE. Thank you very much.

Mr. DOAR. The marriage penalty—

Ms. TANDEN. I would be happy to, and an expansion of the earned income tax credit.

Chairman MURRAY. All right. We will let you have that conversation and get back to you.

Chairman MURRAY. I want to thank everyone for participating today. I apologize. We do all have about 2 minutes to get to a vote, so they are all running. And I particularly thank both of our witnesses who traveled so far today. And I will leave the record open for any additional questions or statements until 6:00 p.m. today.

Thank you very much.

[Whereupon, at 11:33 a.m., the Committee was adjourned.]

# THE PRESIDENT'S FISCAL YEAR 2015 BUDGET PROPOSAL

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**WEDNESDAY, MARCH 5, 2014**

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
*Washington, D.C.*

The Committee met, pursuant to notice, at 10:01 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Whitehouse, Warner, Merkley, Coons, Baldwin, Kaine, King, Sessions, Enzi, Crapo, Graham, Portman, Johnson, and Ayotte.

Staff Present: Evan T. Schatz, Majority Staff Director; and Eric M. Ueland, Minority Staff Director.

## OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. Good morning. This hearing will come to order.

I want to welcome everyone and thank my Ranking Member, Senator Sessions, and all of our colleagues who are joining us for this hearing today. A special thank you to Sylvia Mathews Burwell, who is the Director of the Office of Management and Budget.

It has been nearly a year ago that you were before this Committee for your confirmation, for your nomination. You have been doing a great job since then, during some pretty tough times, and I really am pleased that you are able to join us here today.

In a short few months, we had a Government shutdown in October, followed by the 2-year budget deal in December, and the fiscal year 2014 appropriations process was not finished until January. So the President's budget proposal is understandably a few weeks later than you would have hoped.

But one of the many benefits of the 2-year budget deal is that we have agreement on a bipartisan spending level for 2015. That will enable Congress and the administration to complete our appropriations work on a timely basis this year.

We are going to be discussing the President's 2015 budget proposal today, but I want to take a minute or two to talk about how we got here and what we can do to build on what we have done.

For far too long, Congress has been lurching from one budget crisis to the next, hurting families, devastating our economy, and eroding the trust of the American people in our Government. But at the end of last year, Chairman Ryan and I finally sat down to negotiate in a budget conference.

We both knew we were not going to get everything we wanted. We also knew the country was looking to us to make some compromises and to show that Government could function and that our democracy could work.

So, working closely with many of our colleagues on the Budget Committees, we got to work and put our ideas on the table, made some very tough compromises, focused on what was attainable, put partisanship aside, and we did reach a deal.

Our bipartisan 2-year budget passed with overwhelming support in the Senate and House and was signed into law by President Obama in December.

It rolled back some of the most damaging cuts from sequestration. It prevented Government shutdowns in January and October of this year. It set spending levels for fiscal year 2014. And, critically, because it was a 2-year deal, it set budget levels for fiscal year 2015, which now allows our Appropriations Committees to get to work with a bipartisan spending level. That gives our families and communities across the country the budget certainty that they deserve.

I give Chairman Ryan a lot of credit for his work on our 2-year budget, along with the many Republicans and Democrats who worked with us and supported it.

Nobody thinks our 2-year budget deal was perfect. It was a compromise. And nobody thinks it was the end of the story. Of course it is not. I hope we can work together now to build on that 2-year budget deal and not re-litigate it.

Let us take the opportunity we have here in Congress, finally freed from the manufactured crises, and invest in jobs, broad-based economic growth, and opportunities for our families and communities.

There has been $3.3 trillion of deficit reduction done over the last few years, and it is more than $4 trillion if you include all of the savings from sequestration.

Our deficit is on the path to shrink by about a two-thirds of what it was 5 years ago. And while we absolutely need to tackle our long-term deficit and debt challenges fairly and responsibly, we now have some breathing room to focus on the other deficits that face our country—our deficits in jobs, our deficits in innovation and infrastructure and education.

And that is why I am very glad that we are here today to discuss the President's budget proposal that would build on our bipartisan 2-year budget in exactly this way.

One important way that this budget proposal would build on our 2-year budget deal is through the Opportunity, Growth, and Security Initiative that would further invest in priorities like manufacturing and research and development, military readiness, education, and job training.

The initiative would invest equally in defense and nondefense priorities and fully offset the cost of these additional investments in a balanced and responsible way—very much in the spirit of our bipartisan budget deal.

Like every proposal in the President's budget, we would need a bipartisan agreement to pass it and build on this 2-year budget that we have in place now that will guide the work of the Appropriations Committee this year.

I truly hope Republicans are willing to join us at the table once again to talk about this critical work of investing in jobs and our security in a balanced and fiscally responsible way.

I want to briefly mention just a few of the many strong proposals in the President's budget that I am hoping to hear more about today. I was very glad to see that this budget maintains the commitment to a national preschool initiative. Expanding preschool would not only help our youngest children and pay dividends in future economic growth; it would empower millions of women who would be able to go to work and give back to their communities.

I am also pleased to see that this budget proposal would invest in a skilled health care workforce with clinical training for community health programs. It would strengthen the National Service Corps and increase the number of medical residents for primary care, among other initiatives.

This is an important step to ensure that our families across the country get the care they need. And it is something that should get strong bipartisan support.

I am also very glad to see the budget calls for a reform of the Earned Income Tax Credit for childless workers. The EITC lifts millions of low-income working families out of poverty each year, but it is currently leaving individuals without children behind. Boosting the credit for this segment of the population would further incentivize work and increase economic opportunity for more Americans.

The President's budget also includes a plan to reauthorize our surface transportation programs for 4 years. It would boost infrastructure funding and would address the expected shortfalls in the Highway Trust Fund, which would allow for much-needed investments in our aging infrastructure to help our commuters and our businesses and create jobs for countless Americans.

The budget proposal pays for these investments with the temporary revenue boost that would come during the transition to a fairer and more competitive corporate tax system. This is a fiscally responsible approach to corporate tax reform. And Chairman Camp included a similar proposal to shore up the Highway Trust Fund in the tax reform plan that he released last week. So I think Congress should take a close look at that.

On the individual side of the Tax Code, the President's budget would generate revenue for deficit reduction by eliminating hundreds of billions of dollars in back-door spending that benefits the wealthiest individuals who need it the least.

These reforms would increase the efficiency of our tax system and make our Tax Code fairer to middle-class families.

I am very glad the President has taken a balanced approach with this budget proposal. This is the approach that the vast majority of the American people support. It is fiscally responsible. And it is the right thing to do.

Our Tax Code is riddled with wasteful loopholes and special interest carve-outs. It would be unfair and unacceptable to ignore every last one of them, while calling on seniors and families to bear the burden of deficit reduction alone.

The budget also capitalizes on the savings from declining health care costs. In the past few years, health care costs have grown more slowly than at any other time period since the mid-1960s. I am glad the President's proposal builds on the savings from this decline.

The President's proposal also upholds immigration reform as a way to tackle our long-term deficits. In July of last year, the Congressional Budget Office found that immigration reform would significantly reduce the deficit over the next 20 years and expand the labor force. Passing comprehensive immigration reform is the right thing to do for our families, for our economy, and for the long-term budget outlook.

Finally, I want to note the President's budget this year does not include chained CPI. That is a proposal that has been pushed by Republicans that was included as a compromise offer in his budget last year.

I personally believe there are better ways to create jobs, grow the economy, and tackle our long-term fiscal challenges than this policy. I am glad it was not included this year.

The President's budget is a strong proposal for a long-term plan to build on our 2-year budget deal, create jobs and broad-based growth, and expand opportunities for families and communities across the country.

Congress proved in December that when we work together on a budget, we can invest in our priorities and reduce the deficit. I am hoping that everyone will join us again to continue that work.

And with that, before I turn to Sylvia Burwell, I will ask Senator Sessions for his opening remarks.

## OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you, Chairman Murray, and it is a pleasure to be with you. There is no doubt that Murray-Ryan did avoid uncertainty and helped us in that way. I think we could have done that in a better way, but I do believe that you tried to do the right thing and you passed a law that has helped us.

Ms. Burwell, thank you for contacting us and staying in touch and trying to—I believe you did the best you could to get a budget in on time, although it did not quite meet that, but it is something you promised to try to do, and I know maybe next year you will be able to do that. Thank you for being with us.

Two weeks ago, where you are sitting today, we heard chilling testimony from Director Elmendorf of the Congressional Budget Office that declared the United States was on an unsustainable financial path and that this path leads to the risk of fiscal crisis. The President has proposed a number of ideas in this budget, but mostly it is a tax increase plan to confront our spending deficit problem.

So I was really surprised and stunned that 2 months after the President signed the Ryan-Murray spending caps into law that does, in fact, validate the spending limits we all agreed to and he signed, his budget proposes to dramatically burst through those statutory limits and spend an additional $791 billion, new spending above the growth that we are on today, and that is above the growth line we are on.

Remarkably, in fiscal year 2015, the budget calls for $56 billion more than Ryan-Murray limits. The budget then calls for another huge tax increase of well over $1 trillion and to increase spending by almost $1 trillion. Over 10 years, the President's plan projects mandatory spending to grow 78 percent—and Medicare and Medicaid 73 percent. Means-tested welfare and poverty spending, which now totals $750 billion, is really the largest single Government expense. It continues to grow without reform.

The President's health care law remains perhaps the greatest threat to our financial stability with GAO estimating it would add $6.2 trillion to our long-term unfunded liabilities. So all together, President Obama's budget by his own numbers, your numbers, would add more than $8 trillion to the debt, bringing the total debt from $17 to $25 trillion.

This national profligacy is already inflicting an excruciating toll. Last year we paid our creditors $221 billion in interest on the Federal debt. We spent $40 billion on the highway bill, for example. Under the President's tax and spend plan, he projects, your own numbers, that the annual interest payments will increase to $812 billion in 10 years from today. That is less than CBO's $880 billion, but it is very high. That means that if you took the 150 or so million Americans that would be working 10 years from today, according to estimates, their share, each worker's share of the interest on the debt would be $429 in monthly interest costs and over $5,000 per year on their share of the annual interest every year.

The White House also continues to make unreasonable growth assumptions. The budget you submitted, he submitted, from 2009 through 2012 shows average growth projections for our economy of 3.9 percent. That is double what came in in 2013 last year of 1.9. That is a large difference.

The new White House budget further projects that the economy will grow at 3.1 percent in fiscal year 2014, 3.4 in 2015, and 3.3 in 2016, well above the respected Blue Chip economic estimates.

With regard to the immigration savings that you claim would be accruing, I would note that the income you are projecting of Social Security and Medicare payroll taxes to be paid by illegal immigrants now being given legal status, but that is not your money to be spent. It is their money. It is their Social Security. It is their Medicare. And they will be drawing it out when they become eligible for it. In fact, they will draw out under current law well more than they put in, and that is the problem we are in today. A budget is a document that brings all the President's policies together in one place. It reveals the President's agenda in its entirety.

So what does it show about the plans? Across the board, it showed the President's policies are to further grow the Government and, in effect, the effect is to shrink the private sector and the middle class. The administration appears determined to shield the bureaucracy from accountability and cuts and to spare it from reductions, and that drains American wealth. So American families are struggling under failed policies. We have got to change these. We have got too many energy restrictions. We have got regulations that are reducing productivity and closing factories. We have got a health care law that is hammering the economy and the workforce. We have got a welfare policy that is trapping people into dependency and poverty, not lifting them out; a trade policy that is sending jobs overseas; an immigration policy that CBO tells us will pull down wages for over a decade for American working people; a tax burden that undermines our ability to compete; and a crushing debt burden that is sapping our confidence and the vitality of our economy.

So the President's budget proposes dozens of new taxes, new spending programs, and Government initiatives. It does nothing to fix our fiscally unsound Medicare and Social Security programs. This will have to be done. But the President will have over 8 years done not one thing to save or fix these programs, leaving his successor with an even harder challenge.

Nor has the President done anything to contain soaring welfare costs. In fact, his administration has surged welfare spending and has been an obstacle to reform and accountability.

And, finally, the biggest failure displayed in this budget presentation is that the President for political purposes refuses to look the American people in the eye and tell them the truth: that we are on an unsustainable fiscal path. He refuses to rally the Nation to avoid a fiscal crisis. If he would do so, I have no doubt the American people would respond, and we could meet this challenge. I can only assume he does not do so because it would interfere with his plan for ever growing the Government bigger and bigger, therefore requiring the American people, he thinks to raise more and more taxes.

So the President's policy was made clear last week when the White House declared, colleagues, that the era of austerity is over. Everyone here knows the significance of that statement. It meant that he is going to oppose programs that would end the growth in spending at the rate we are now on. And he is abandoning as a priority the containing of debt growth in America.

I know you score that there is a reduction in deficits, but that assumes over $1 trillion in new taxes that will not occur. They are not going to occur. You have already had over $2 trillion in new taxes in the time the President has been here, and these new taxes are not going to occur. So you have more spending, assuming we are going to have tax increases that will not occur, and I think that is a path to problem, not prosperity.

I thank you, Madam Chairman, for the opportunity to share these remarks.

Ms. Burwell, you have got a challenging job. I know it is. I know it is hard. I hope that you have been able to look some of those claimers for money in the eye and say, "Sorry, we do not have enough money. Go back to your departments and see if you cannot save some." I know you will try to do that as you can.

Thank you, Madam Chair.

Chairman MURRAY. Thank you very much.

With that, we will turn it over to you for your testimony, Director Burwell.

**STATEMENT OF THE HONORABLE SYLVIA MATHEWS BURWELL, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET**

Ms. BURWELL. Thank you. Thank you, Chairman Murray and Ranking Member Sessions, members of the Committee. Thank you for welcoming me here today and giving me the opportunity to present the President's 2015 budget.

The President's budget provides a fiscal road map for accelerating economic, expanding opportunity, and ensuring fiscal responsibility. It includes fully-paid-for investments in infrastructure, job training, preschool, and pro-work tax cuts. At the same time, it reduces deficits and strengthens our long-term fiscal outlook through additional health care reforms, tax reforms, and by fixing our broken immigration system.

In recognition of the important bipartisan funding compromise reached by the Congress in December, the budget shows the President's funding priorities at the 2015 spending levels agreed to in the Bipartisan Budget Act. However, those levels are not sufficient both in 2015 and beyond to ensure that the Nation is achieving its full potential.

For that reason, the budget also shows how to build on the progress made by that compromise agreement with a fully-paid-for $56 Opportunity, Growth, and Security Initiative that supports investments in critical areas such as education, research, manufacturing, and defense.

Building on the model that was established in the Murray-Ryan compromise, the initiative is split evenly between defense and nondefense priorities and is fully paid for. So it is deficit neutral.

Supporting what the President said in the State of the Union, the budget includes a series of measures to create jobs and accelerate economic growth. For example, the budget lays out an ambitious 4-year, $302 billion transportation proposal paid for with the transition revenue of pro-growth business tax reform. It invests in American innovation and strengthens our manufacturing base by supporting the President's goal of creating a national network of 45 manufacturing institutes. It maintains U.S. leadership in research by making the R&D tax credit permanent and continuing to support groundbreaking basic and applied research across a range of fields. And it enhances the administration's management efforts to deliver a Government that is more effective, efficient, and supportive of economic growth, focusing on areas directly impacting citizens and businesses.

The budget also includes measures designed to expand opportunity for all Americans. For example, it doubles the maximum value of the earned income tax credit for childless workers to build on the EITC's success in encouraging people to enter the workforce and reduce poverty. It invests in the President's vision of making access to high-quality preschool available to every 4-year-old child. And it invests in new efforts to drive greater performance and innovation in workforce training to equip American workers with the skills that match the needs of employers.

To ensure the Nation's long-term fiscal strength, the budget focuses on the primary drivers of long-term debt and deficits, particularly in the health care growth area and in adequate revenues to meet the needs of our aging population.

It builds on the savings and reforms in the Affordable Care Act, with another $400 billion in health care savings aimed at continuing to slow the growth of health care costs and improve the quality of care.

It curbs inefficient tax breaks that benefit the wealthiest and ensures that everyone is paying their fair share. It also calls for progrowth immigration reform, which we know would promote economic growth as well as reduce the deficit.

Under the President's leadership, the deficit has already been cut in half as a share of the economy. By paying for new investments and tackling our true fiscal challenges, the budget continues that progress, reducing deficits as a share of GDP to 1.6 percent, and stabilizing debt as a share of the economy by 2015 and putting it on a declining path.

The budget shows the President's vision for moving the country forward. It provides a responsible, balanced, concrete plan for accelerating economic growth, expanding opportunity for all Americans, and ensuring fiscal responsibility.

I look forward to working with the Congress and this Committee in the coming months. Thank you.

[The prepared statement of Ms. Burwell follows:]

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**TESTIMONY OF**
**SYLVIA M. BURWELL**
**DIRECTOR**
**OFFICE OF MANAGEMENT AND BUDGET**
**BEFORE**
**SENATE COMMITTEE ON THE BUDGET**

**March 5, 2014**

Chairman Murray, Ranking Member Sessions, members of the Committee, thank you for welcoming me here today, and giving me the opportunity to present the President's 2015 Budget.

**Opportunity for All**

The President's Budget outlines his economic vision, defining the investments and choices that will accelerate economic growth, create opportunity for all Americans, and ensure fiscal responsibility. The Budget proposes fully paid for investments in infrastructure, job training, preschool, and pro-work tax cuts, while accelerating growth and reducing deficits through health, tax, and immigration reform.

The Budget adheres to the 2015 spending levels agreed to in the Bipartisan Budget Act and shows the choices the President would make at those levels. But the Budget also shows how to build on the progress made by that compromise agreement with a fully paid for $56 billion Opportunity, Growth, and Security Initiative that supports investments we need in education, infrastructure, research, national security, and other areas. The Initiative is split evenly between defense and non-defense priorities and is fully paid for with spending reforms and the closing of tax loopholes.

In the remainder of my testimony, I will describe the Budget's major policies in more detail. These include:

- An ambitious, four-year $302 billion surface transportation reauthorization proposal paid for with the transition revenue from pro-growth business tax reform. Both components of this proposal have bipartisan support and would create jobs and promote strong economic growth;
- A proposal to strengthen our manufacturing base, transforming regions across the country into global epicenters of advanced manufacturing and building a network of 45 manufacturing institutes;
- Proposals to maintain U.S. leadership in research by making the R&D tax credit permanent and continuing to support ground-breaking basic and applied research across a range of fields;
- A major early childhood education initiative to make high-quality preschool available to every four-year-old child;

- Investments in on-the-job workforce training, apprenticeships, and other steps to equip workers with skills that match the needs of employers;
- Pro-work, pro-family tax cuts, including an Earned Income Tax Credit (EITC) expansion for workers without children, and improvements to middle class child care, education, and retirement tax benefits; and
- Enhanced management efforts to deliver a Government that is more effective, efficient, and supportive of economic growth, including initiatives to deliver better, faster, and smarter services to citizens and businesses.

Meanwhile, the Budget continues to reduce our deficits through a balanced approach focused on the primary drivers of long-term deficits and debt – health care cost growth and inadequate revenues to care for our aging population – while making needed investments to grow our economy. It builds on the savings and reforms in Affordable Care Act with additional measures to strengthen Medicare and Medicaid, maintain the recent, historic slow-down in health care cost growth, and improve the quality of care. The Budget would also reform our tax system by curbing inefficient tax breaks for the highest-income Americans, and it supports commonsense reform of our broken immigration system, which independent economists say will grow our economy and shrink our deficits. By paying for new investments and tackling our true fiscal challenges, the Budget reduces deficits to 1.6 percent of GDP by 2024 and puts debt on a declining path, reaching 69 percent of GDP in 2024.

**Building on our Progress to Date**

Despite challenges, under the President's leadership the economic recovery has been sustained and durable, creating more than eight million private-sector jobs over the last four years and bringing unemployment to its lowest level in over five years. Deficits have been cut in half since the President took office – the fastest period of sustained deficit reduction since the demobilization immediately following World War II – and the actions the President has taken to invest in job creation and growth, bipartisan efforts to cut spending, changes to the tax code that ensure that the wealthiest Americans pay a fairer share, and a slowdown in the growth in health care costs, supported in part by the Affordable Care Act, have all contributed to this improving economic and fiscal picture.

Ensuring that the Federal Government is helping, not hurting, economic growth and fiscal stability is critical to maintaining this momentum. Unfortunately, avoidable crises in the recent past, including sequestration, a government shutdown, and uncertainty over the lifting of the debt ceiling, have unnecessarily harmed the economy and job growth and cast doubt on the government's resolve to meet commitments to seniors and the most vulnerable. For example, the Congressional Budget Office estimated that the 2013 sequestration reduced real GDP growth by about 0.6 percentage points in calendar year 2013 and cost 750,000 jobs. And private sector economists estimated that the government shutdown reduced the annualized growth rate of GDP in the fourth quarter of 2013 by 0.2 to 0.6 percentage points.

There are reasons to be optimistic that we will be able to avoid these challenges going forward. Late last year, thanks to the hard work of Chairmen Murray and Ryan and members of this Committee, the President signed the Bipartisan Budget Act (BBA) that made it possible to partially avoid some of the severe cuts to discretionary funding for priorities like education, research, infrastructure and national security. The cuts were replaced with more sensible deficit reduction measures – including a number of reforms proposed in the President's 2014 Budget. This was followed in January under the leadership of Appropriations Committee Chairmen Mikulski and Rogers with Congress again working across the aisle to agree to appropriations that provide funding for investments that will help grow our economy, create jobs, strengthen the middle class, and support our national security. While compromise is never perfect and no one got everything they wanted, these were important steps in returning to a more regular budget process, with appropriate give-and-take, that could help our economy move forward.

Our job now is to continue to build on this progress.

**The President's Vision for Investing in Our Nation's Future**

While the recent bipartisan budget and appropriations agreements were important first steps toward ending manufactured crises and replacing the damaging cuts caused by sequestration, the job is not finished. In particular, while the BBA replaced half of the discretionary sequestration cuts for 2014, it replaced only one-fifth of the scheduled cuts in discretionary funding for 2015 and provided no relief in 2016 and beyond. As a result, taking into account projected growth in programs such as veterans' medical care and other factors, the current non-defense discretionary funding caps for 2015 will be functionally several billion dollars below the levels Congress provided for 2014. The 2015 caps are below 2007 funding levels adjusted for inflation, even though the need for smart pro-growth investments in infrastructure, education, and innovation has only increased due to the Great Recession and its aftermath.

Recognizing the importance of the recent bipartisan compromise, the President's Budget shows how the Administration would adhere to the spending levels agreed to in the BBA in 2015, and proposes difficult cuts and reforms to make room for investments in priority areas such as research, clean energy, early learning, and ending homelessness. But even with those tough cuts and reforms, the discretionary levels set by the BBA are not sufficient – both in 2015 and beyond – to ensure the nation is achieving its full potential in creating jobs, growing the economy and promoting opportunity for all.

For these reasons, in 2015, the Budget includes a separate, fully paid for $56 billion Opportunity, Growth, and Security Initiative – split evenly between defense and non-defense funding – that shows how additional discretionary investments can spur economic progress and strengthen our national security. After 2015, the Budget proposes a long-term discretionary path that will allow us to sufficiently and smartly invest in critical priorities such as education, innovation, infrastructure and security, with a focus on long-term savings rather than short-sighted, short-term austerity.

The Opportunity, Growth, and Security Initiative will help restore our global edge in basic research, provide funding to support high-quality early education across the country, and train teachers to take advantage of broadband technology in the classroom. It will invest in our communities through emergency response activities, juvenile justice programs, and Promise Neighborhoods, and will fund a national network of manufacturing institutes that will spur economic development. It will put people back to work, restoring our national parks, renovating veterans' hospitals, and building resilient infrastructure that will help our communities prepare for the effects of climate change. It will support partnerships between community colleges and employers to train workers for jobs that are in demand, including a bold new expansion of apprenticeship programs. It will help us put a stop to short-sighted cuts to government operations that compromise efficiency and effectiveness, and cost money over the long run, such as growing deferred maintenance backlogs, sharp cuts to Federal employee training, and erosions in customer service at agencies like the Internal Revenue Service. And it will provide relief from the damage done to core defense priorities due to sequestration cuts, accelerating the modernization of key weapons systems, making faster progress toward restoring readiness, supporting nuclear R&D and infrastructure, and improving defense facilities and investing in military construction projects across the country.

Importantly, the Budget also shows that this initiative is affordable if Congress is willing to enact a few common-sense spending and tax changes. Building on the model established in the BBA, the Budget outlines a specific set of mandatory spending reforms and tax loophole closers that would fully offset the cost of the Opportunity, Growth, and Security Initiative, including reforming Federal crop insurance, reallocating spectrum to promote economic growth, preventing individuals from collecting full Unemployment and Disability Insurance benefits for the same period of time, and reducing tax benefits for multi-million dollar retirement accounts. Discretionary investments after 2015 would also be paid for with targeted mandatory reductions and common-sense tax reforms.

The President agrees that we should continue to responsibly constrain discretionary spending, eliminating wasteful or unnecessary spending and reforming Federal programs to enhance their effectiveness and impact wherever we are able. In fact, discretionary spending under the President's Budget will still be nearly $250 billion below the original levels agreed to in the Budget Control Act for 2015-2021, and will be brought to the lowest levels as a percentage of the economy in over 50 years. At the same time, the President believes that we need to invest to move our economy forward, create jobs, and expand opportunity for all. And when it comes to reducing our deficits, the President believes the right approach is to focus on the true drivers of our long-term fiscal challenges, not to impose additional short-term austerity that will hold the economy back.

**Building a 21st Century Infrastructure**

Building a durable and reliable infrastructure will create good jobs that cannot be outsourced, and will provide businesses with the transportation and communication networks our economy needs. For that reason, the Budget includes significant investments to repair our existing infrastructure and build the infrastructure of tomorrow.

Last summer, the President introduced a proposal to couple investments in infrastructure with business tax reform that lowers rates, eliminates loopholes and inefficient tax subsidies, cuts taxes for small businesses, and reforms the international tax system to promote investment and job creation in the United States. Specifically, the proposal would devote the one-time transition revenue resulting from business tax reform to the Highway Trust Fund – the same approach House Ways and Means Chairman Camp took in the tax reform plan he released last week. The President's proposal will fill the Highway Trust Fund funding shortfall and make critical new infrastructure investments as part of a four-year, $302 billion surface transportation reauthorization proposal. The President's plan to rebuild America will increase "fix-it-first" investment to repair and modernize our highways, bridges, and transit systems, while also making new investments to expand transit and passenger rail access, decongest our freight networks, and encourage innovation through competitive programs such as TIGER grants. And it will advance the President's Climate Action Plan by building more resilient infrastructure and reducing transportation emissions by responding to the greater demand and travel growth in public transit.

Beyond this proposal, the Budget would also take a number of other steps to expand infrastructure investment. The President continues to push for efforts that will help catalyze private investment in infrastructure, such as a National Infrastructure Bank with the ability to leverage private and public capital to support infrastructure projects of national and regional significance, as well as the creation of America Fast Forward (AFF) Bonds program that will attract new sources of capital for infrastructure investment in a way that is cost-effective for taxpayers. The Budget includes funding for a new Interagency Infrastructure Permitting Improvement Center housed at the Department of Transportation, which will build on efforts already underway as part of the President's Management Agenda to expedite the Federal permitting process and get job creating projects off the ground faster while delivering better outcomes for communities and the environment. And it will take steps to support our National Parks and lands, including through a new National Parks Centennial Initiative that will put thousands of youth, returning veterans, and other Americans back to work each year restoring some of our greatest historical, cultural, and natural treasures.

**Investing in Jobs, Economic Growth and Opportunity**

To compete in the 21st Century and make America a magnet for job creation and opportunity, we need to invest in American innovation, strengthening our manufacturing base and keeping our nation at the forefront of technological advancement. And to ensure our energy security and address global climate change, we must continue to focus on domestic energy production, the development of clean energy alternatives, and the promotion of energy efficiency. The Budget includes investments in advanced manufacturing, research and development (R&D), and clean energy and energy efficiency technologies.

To help make America a magnet for jobs, the Budget supports investment and accelerates innovation in U.S. manufacturing, including supporting the President's goal of creating 45 new manufacturing innovation institutes over 10 years. It also helps to attract investment to our shores by significantly enhancing and expanding SelectUSA.

Continuing our commitment to world-class science and research, the Budget provides $135 billion for R&D activities across government, while targeting resources to those areas most likely to directly contribute to the creation of transformational technologies that can create the businesses and jobs of the future. This includes increased funding for clean energy technology investment at the Department of Energy's Office of Energy Efficiency and Renewable Energy and the Advanced Research Projects Agency – Energy. It also includes robust support for biomedical research at the National Institutes of Health (NIH), providing about 9,500 new NIH grants, and investing in the fights against Alzheimer's disease, cancer and other diseases that affect millions of Americans. The funding provided for NIH would also support the BRAIN initiative – which will help revolutionize our understanding of how the human brain processes, stores and retrieves information – and allow for the development of a new health research program modeled after the Defense Advanced Research Projects Agency (DARPA) and designed to fund innovative projects and accelerate the discovery of life-saving treatments and cures. It supports research in areas important to American agriculture, including through funding three multidisciplinary institutes dedicated to crop science and pollinator health, advanced bio-based manufacturing and anti-microbial research. It reforms and makes permanent the Research and Experimentation (R&E) Tax Credit in order to support applied R&D activities. As part of the President's Management Agenda, the Budget invests in accelerating and institutionalizing lab-to-market practices, including through an expansion of the National Science Foundation's "Innovation Corps" program.

To help secure America's energy future and cut carbon pollution, the Budget invests in clean energy, improving energy security, and enhancing preparedness and resilience to climate change. It takes steps to reach the President's goal of cutting in half the energy wasted by America's homes and businesses. It helps move us further down the path towards energy security by reducing net oil imports, including through an Energy Security Trust to help fund efforts to shift our cars and trucks off oil and by continuing to support the President's "all of the above" strategy for developing domestic energy resources. It includes reforms to promote responsible oil and gas development on Federal lands. And it helps meet the challenge of climate change, strengthening U.S. global leadership on climate issues and investing over $1 billion through the Opportunity, Growth, and Security Initiative to make our communities and our infrastructure more resilient to the damaging effects of a changing climate. All of these investments are critical components of the President's Climate Action Plan, bringing about a clean energy economy with new businesses, jobs, and opportunities for American workers.

**Equipping Every American with a High-Quality Education and the Skills to Succeed**

Americans must be prepared with the skills and knowledge necessary to compete in the 21st Century economy. Expanding educational opportunities is critical to equipping all children with these skills and positioning them to succeed as adults. The Budget includes investments and initiatives to improve all levels of education, from early childhood through college, as well as significant new efforts to ensure our workforce has the skills needed by American businesses.

To expand early childhood education, the Budget includes the Preschool for All initiative proposed by the President last year, which calls for partnering with States to provide every four year-old child access to high-quality preschool. This initiative will be fully paid for by raising Federal tobacco taxes, which will also help to discourage youth smoking and save lives. In addition, the Budget invests $15 billion in mandatory funds over the next 10 years to extend and expand evidence-based, voluntary home visiting programs, which enable nurses, social workers, and other professionals to connect families to services and educational supports that improve a child's health, development, and ability to learn. And the Budget builds on the progress made in the 2014 appropriations act with additional resources for Preschool Development Grants, to help states and communities lay a stronger foundation for Preschool for All, and Early Head Start-Child Care Partnerships, to expand access to high-quality infant and toddler care. Funding for these critical initiatives is also included in the Opportunity, Growth, and Security Initiative.

The Budget also takes steps to improve K-12 education, launching a Race to the Top aimed at closing the achievement gap, and providing $150 million for a new program to redesign high schools to focus on providing students challenging, relevant learning experiences, and rewarding high schools that develop new partnerships with colleges and employers to help develop the skills students need for jobs now and in the future. Building on the President's call to the Federal Communications Commission (FCC) to take steps to connect 99 percent of American students to the digital age through next-generation broadband and wireless in their schools and libraries, the Budget (including through the Opportunity, Growth, and Security Initiative) also makes available $500 million for the ConnectEDucators program, which will provide 100,000 teachers in 500 school districts across the country access to professional development and digital instructional resources to take advantage of broadband in the classroom.

As a critical part of his education agenda, the President has also placed a high priority on making college affordable and helping Americans obtain a meaningful college degree. The Budget builds on prior efforts by supporting the development and refinement of the new college ratings system the President announced last summer that will identify colleges that provide the best value to students and encourage all colleges to improve. The Budget also provides new incentives to states and schools to focus on improving outcomes, with new College Opportunity and Graduation Bonuses to reward colleges for improving educational outcomes for low- and moderate-income students and a State Higher Education Performance Fund to support states committed to improving performance at public institutions. And the Budget includes an expansion of "Pay As You Earn" (PAYE) repayment options to all student borrowers, and reforms the PAYE terms to ensure that the program is well-targeted and provides a safeguard against raising tuition at high-cost institutions.

In addition to providing a strong educational foundation, the President believes that we need to equip our workforce with the skills to pursue in-demand jobs and careers. The Budget's approach to skills and training is guided by the principle that all Federal investments should be designed to equip workers and job seekers with skills matching the needs of employers looking to hire. This includes significant new investments at the Department of Labor to drive greater performance and innovation in serving workers with the greatest barriers to employment, as well as investments in the Opportunity, Growth, and Security Initiative such as a new competitive Community College Job-Driven Training Fund and doubling the number of apprenticeships in the United States over the next five years. The Budget also provides resources for new public-private partnerships to help the long-term unemployed transition back into good jobs that can support their families, while continuing to call on Congress to extend unemployment insurance for the 1.7 million Americans who have lost this vital economic lifeline.

**Expanding Opportunity for Middle Class Security**

To build real, lasting economic security we need to create more opportunities for all working and middle class Americans to get ahead. The Budget includes a series of proposals to make sure that workers have the wages and protections they deserve, while expanding assistance to the most vulnerable.

Over the past 30 years, modest minimum wage increases have not kept pace with the higher costs of basic necessities for working families. That is why the President is calling on Congress to raise the Federal minimum wage in stages to \$10.10 per hour and index it to inflation thereafter, while also raising the minimum wage for tipped workers for the first time in over 20 years. The President is leading by example by signing an Executive Order to raise the minimum wage to \$10.10 for individuals working under new and replacement Federal service contracts. Beyond increasing the minimum wage, the Budget also calls for other protections for workers, including increasing enforcement of the laws that ensure workers receive appropriate wages and overtime pay, as well as the right to take job-protected leave for family and medical purposes. And to help the many working families who cannot afford to take unpaid leave, the Budget supports State paid leave programs, particularly through the Opportunity, Growth, and Security Initiative.

The Budget helps advance the Administration's Promise Zone initiative, which supports partnerships between the Federal government, local communities, and businesses to create jobs, increase economic security, expand educational opportunities, increase access to quality, affordable housing, and improve public safety. Through a combination of the base budget and the additional resources provided in the Opportunity, Growth, and Security Initiative, the Budget will support the President's vision for Promise Zones by funding 40 new Promise Neighborhoods and 10-14 new Choice Neighborhoods.

Few things help Americans pull themselves up through hard work like the Earned Income Tax Credit (EITC). However, the maximum EITC available to childless workers (including non-custodial parents) is too small and the credit is unavailable to workers under age 25, which means that it cannot shape work decisions during the crucial years at the beginning of a young person's career. The Budget will double the maximum credit, make the credit available to those workers who have an income consistent with full-time minimum wage work at the current minimum wage, and lower the age limit to 21, as a way to support and reward work. The proposal will also update the childless worker EITC upper age limit to 66, consistent with the Social Security Normal Retirement Age. These changes will be paid for by closing tax loopholes that let some high-income professionals avoid income and payroll taxes. In addition, the Budget also makes permanent important improvements to the EITC and Child Tax Credit for families with children, and it proposes improvements to tax benefits that help middle class and working families pay for child care and college and save for retirement.

Finally, the Budget invests in achieving the ambitious goals set by the President to end homelessness across the country. By investing in homeless assistance and supportive services programs at both the Department of Housing and Urban Development and the Department of Veterans Affairs, the Budget keeps us on a path to end veterans' homelessness in 2015 and end chronic homelessness in 2016. In addition, the Budget makes investments in rental assistance, which plays an important role in helping extremely low-income families avoid homelessness by providing stable and affordable housing.

**Providing all Americans Access to Affordable Health Care**

The Affordable Care Act (ACA) has taken historic and significant steps toward putting the nation back on a sustainable fiscal course while laying the foundation for a higher quality, more secure health care system. Through premium tax credit and cost sharing assistance to make coverage affordable and increased Federal support to States expanding Medicaid coverage for low-income adults, the ACA ensures that every American can access high-quality, affordable coverage, providing health insurance to millions of Americans who would otherwise be uninsured.

With the full implementation of the ACA beginning this year, millions of people have enrolled in either private insurance through the Health Insurance Marketplace or coverage through Medicaid and the Children's Health Insurance Program (CHIP). Additionally, more than 3 million young adults have already gained coverage under the health care law by staying on their parents' plans until their $26^{th}$ birthday.

Continuing to efficiently and effectively implement the ACA is one of the Administration's highest priorities. The Budget fully funds the ongoing implementation of the ACA, which is already providing coverage for millions of Americans that previously did not have access to affordable health care.

The Budget also invests in the health care workforce to improve access to health care services, including support for 15,000 providers in the National Health Service Corps that will serve areas across the country experiencing a shortage of medical providers. In addition, the Budget creates new graduate medical education residency slots in primary care and other specialties experiencing shortages. Most of these new residents will be trained in community-based settings, including rural and underserved areas.

**Ensuring Our Nation's Safety and Security**

Economic growth and opportunity can only be achieved if America is safe, secure, and resilient, both at home and abroad.

At home, the Budget supports the President's "Now is the Time" initiative, a set of concrete policies to help reduce gun violence in our schools and communities in the wake of the Sandy Hook Elementary School tragedy. This includes support for additional background checks, continued focus on inspections of Federally-licensed firearms dealers, improved tracing and ballistics analysis, and efforts to keep guns out of the hands of dangerous criminals and other prohibited persons, as well as training for state and local law enforcement to prevent and respond to active shooters and prevent mass casualties. The Budget also enhances our ability to identify and address mental health issues early and continues support for the Comprehensive School Safety Program and other initiatives to enhance our schools' physical security and create safer and more nurturing school climates that help prevent violence. The Budget also works to maintain high safety standards outside of our schools, addressing risks to our transportation sector through new investments in data-driven safety interventions, research and testing, additional safety personnel, emergency response training, community outreach, and other strategies, as well as a Pipeline Safety Reform initiative to both enhance and revamp the federal standards that help protect the Nation's safety.

Abroad, the Budget advances the Administration's national security objectives and provides the resources and capabilities to protect our security and interests around the world. Funds provided for the Department of Defense will sustain our ability to project power and win decisively against state adversaries and terrorist threats, make progress toward restoring balance to our military and raising readiness levels negatively impacted by sequestration, and ensure a safe, secure, and effective nuclear deterrent. The Budget also continues to support U.S. security, diplomatic, and development goals in Afghanistan while scaling down military operations and assistance. At the same time, the Budget makes strategic, coordinated and Government-wide investments in a wide range of tools that will help rebalance American engagement towards the Asia-Pacific region, which will help create American jobs, empower American businesses, and maintain the security and stability necessary for economic growth. The Budget also provides $4.6 billion for Department of State security programs, including security staff, construction, and infrastructure upgrades. These and other investments will ensure that the Administration continues to safeguard over 86,000 U.S. Government employees, from more than 30 agency components, in more secure overseas working environments. And the Budget identifies and promotes cross-agency cybersecurity initiatives and priorities to help us stay ahead of constantly evolving cyber threats.

The Budget also makes significant investments in reforms and economic development overseas. As part of the Power Africa initiative, the Budget supports a variety of investments at the Millennium Challenge Corporation, the Export-Import Bank, the Overseas Private Investment Corporation and elsewhere that will support Africa's energy sector and expand the markets for U.S. goods in sub-Saharan Africa. Building on the Administration's significant and continuing response to the transformative events in the Middle East and North Africa (MENA) region, the Budget includes

$1.5 billion to respond to the crisis in Syria, including providing humanitarian assistance, and continues to support transitions and reforms in the region. And the Budget continues the Administration's efforts to invest toward the goals of achieving an AIDS-free generation and an end to preventable child and maternal deaths.

Our Nation also has a solemn obligation to take care of our servicemembers and veterans. To deliver on this commitment, the Budget provides significant resources to support veterans' medical care, help military families, assist servicemembers transitioning to civilian life, reduce veterans' homelessness, and improve the disability claims processing system. It also calls for reforms to our military compensation system, ensuring that service members continue to be properly compensated for their service to the country while also delivering on our responsibility to provide them with the finest equipment and training possible.

**Reducing Long-Run Deficits and Promoting Sustainable Growth**

The President's Budget invests in areas that will grow the economy, create jobs, and increase opportunity for all Americans, while focusing squarely on the primary drivers of our long-term deficits and debt – health care cost growth and inadequate revenues to care for our aging population – and making needed investments to grow our economy. The Budget does this by addressing the increasing costs of health care, ensuring the government efficiently and fairly generates the revenue we need to invest in critical areas and make good on our commitments, and promoting commonsense immigration reform that will help balance out an aging population.

To start with, the Budget includes $402 billion in specified health savings over 10 years that build on the achievements of the Affordable Care Act by eliminating excess payments and fraud and supporting reforms that boost the quality of care, while at the same time extending the solvency of the Medicare Trust Fund by roughly five years. It accomplishes this without shifting significant risks onto individuals, slashing benefits, or undermining the fundamental compact these programs represent to our Nation's seniors, people with disabilities, and low-income families. It includes several reforms that would eliminate excess payments and bring Medicare payments more in line with patient care costs. For example, the Budget recoups excess payments to drug manufacturers by requiring rebates for drugs provided to 12 million low-income Medicare beneficiaries, consistent with rebates provided for Medicaid beneficiaries, and by increasing manufacturer discounts for brand drugs in the Part D coverage gap. It seeks to reduce fraud and waste in our health programs through proposals to reduce improper payments and improve program integrity monitoring and compliance. For example, the Budget proposes to direct States to track high prescribers and utilizers of prescription drugs in Medicaid to identify aberrant billing and prescribing patterns. And it includes reforms that help control long-term costs in the Medicare program, including reforms that would encourage beneficiaries to seek high-value services through targeted changes in cost sharing and premiums.

Slowing health care cost growth – through both the steps taken in the ACA and the Budget's additional health reforms – addresses the most pressing challenge to long term fiscal sustainability. But over the coming decades, an aging population will also put increasing pressure on the budget. Even with reforms to health programs and tough choices that will bring discretionary spending to historically low levels as a share of GDP, we will need additional revenue to maintain our commitments to seniors, veterans, and others, while making the investments that are needed to grow our economy and expand opportunity.

The President believes that we can obtain that needed revenue by reforming our tax code to reduce inefficient tax breaks. Tax reform holds the potential to improve economic growth by reducing complexity for individuals and small businesses, curbing inefficient tax subsidies that distort individual and business decision-making, and reducing the deficit. As a first step toward balanced deficit reduction and tax reform, the President proposes that Congress immediately enact measures that would raise $650 billion in revenue by broadening the tax base and reducing tax benefits for those who need them the least – without increasing marginal tax rates. These proposals will prevent high-income households from using tax preferences, including low tax rates on capital gains and dividends, to reduce their total tax bills to less than what many middle class families pay. Beyond these measures, the President is committed to working with Congress to further reform the tax code to make it fairer, promote economic growth and job creation, and improve competitiveness.

And finally, the President believes that we must fix our immigration system by continuing to strengthen border security, cracking down on employers who hire undocumented workers, modernizing our legal immigration system, and providing a pathway to earned citizenship for hardworking men and women who pay a penalty and taxes, learn English, pass a background check, and go to the back of the line. In addition to contributing to a safer and more just society and promoting economic growth, common-sense immigration reform will also significantly reduce our long-term deficits, strengthen Social Security, and help balance out an aging population. The Congressional Budget Office estimated that the immigration bill that passed with bipartisan support in the Senate last year would reduce the deficit by about $160 billion in the first decade and by about $850 billion over 20 years. Meanwhile, the Social Security actuaries found that the Senate bill would reduce the Social Security shortfall by about $300 billion over the first 10 years and would close roughly 8 percent of the 75-year Social Security shortfall. The Administration supports the Senate approach, and calls on the House of Representatives to act on comprehensive immigration reform this year.

In total, these measures are more than enough to achieve the key fiscal goal that nearly all economists and CBO have identified as the best measure of our long-term fiscal stability – stabilizing the debt as a share of GDP. If the President's policies are implemented, debt would peak at 74.6 percent of GDP in 2015 and then decline each year after that, falling to 69.0 percent of GDP in 2024. And deficits would be below their 40-year historical average every year after 2015, declining to 1.6 percent of GDP by 2024.

**Reforming Government**

The President's vision for a responsible budget is not only about investing in a fiscally responsible way that cuts deficits and stabilizes our debt. It is also about making the institution of government more effective and efficient, improving government management, cutting programs that do not work, and reforming the way we do business to better serve the public and help grow the economy. The Budget advances this Management Agenda in a number of ways, introducing specific programmatic reforms, improving customer service across government, and investing in government-wide management initiatives that will create a government designed for the 21st Century.

The President is also committed to reducing overlap and duplication in Federal programs, improving their effectiveness and eliminating waste. As an example, the Budget proposes a fresh

Government-wide reorganization of science, technology, engineering, and mathematics (STEM) education programs designed to enable more strategic investment in STEM education and more critical evaluation of outcomes, while leveraging government resources more effectively to meet national goals. This proposal reduces fragmentation of STEM education programs across government, and focuses efforts around the five key areas identified by the Federal STEM Education 5-Year Strategic Plan: P-12 instruction; undergraduate education; graduate education; broadening participation in STEM to women and minorities traditionally underrepresented in these fields; and education activities that typically take place outside of the classroom.

The Budget also takes steps to improve the way we fund key priorities, ensuring that Federal dollars are used to maximum effect. For example, the Budget proposes a significant reform to address wildfire suppression costs that have cannibalized forest health and rehabilitation programs, creating a dedicated source of funding in order to provide certainty in future years for firefighting costs, free up resources to invest in areas that will promote long-term forest health and preservation, and maintain fiscal responsibility by addressing wildfire disaster needs through agreed-upon funding mechanisms.

The Budget also commits to expanding the use of evidence and rigorous evaluation in budget, management, and policy decisions, making better use of government data, conducting new program evaluations, and adopting evidence-based decision making structures to ensure that funds are used to their greatest effect. For example, the Budget provides new authority and new resources for the Social Security Administration, in partnership with other Federal agencies, to test innovative strategies to help people with disabilities remain in the workforce. The Budget also includes proposals to build on efforts already underway in areas such as Pay for Success and tiered-evidence programs, for example the Investing in Innovation Fund at the Department of Education, that are designed to encourage innovation while building evidence about what works and shifting resources toward the most promising approaches.

Finally, the Budget makes sure that government itself runs more efficiently and effectively. It includes initiatives to deliver better, faster, and smarter services to citizens and businesses, including supporting critical customer service improvements at the Internal Revenue Service and the Social Security Administration. It advances the Administration's effort to modernize the infrastructure permitting process, cutting through red tape, allowing us to get more construction workers on the job faster, and achieving better outcomes for our communities and environment. It expands the use of shared services between Federal agencies and strategic sourcing to leverage the buying power of the government, bringing greater value and efficiency for taxpayer dollars. It continues to open government data and research for public and private sector use to spur innovation and job creation. And it invests in the Federal workforce, supporting the development of Government-wide enterprise training and resource exchanges and enabling agencies to hire the best talent from all segments of society, helping to ensure that the Federal government can attract, develop, and retain a high-quality workforce to serve the American people.

**Conclusion**

The President's Budget provides a fiscal roadmap for delivering stronger growth and job creation, expanded opportunity for all Americans, and fiscal responsibility. And it shows how we can build on the progress that has been made over the last five years and ensure that our country remains strong and prosperous, both now and in future. I look forward to working with Congress and this Committee in the coming months to advance that goal.

Chairman MURRAY. Thank you very much.

You know, it was really important to Chairman Ryan and me, as well as a lot of our colleagues on this Committee, that we set a level not only for 2014 but for 2015 as well so that we could get back to our work to pass appropriations and focus on our other priorities.

I have made it very clear the Bipartisan Budget Act is not the deal I would have written on my own, and I acknowledge that the funding levels for 2015 will be very tight.

So, first, Director Burwell, as someone who oversees the budget and the appropriations process from the executive side, can you comment on the value you see in Congress having set aside the fights of the recent years and agreed upon a bipartisan funding level for the upcoming budget year?

Ms. BURWELL. I would focus on the benefits in two ways. One are the direct benefits to the American people in terms of what the deal did. By setting the levels in 2014 and 2015, the deal provided I think much needed relief in the sequester space that was paid for, so it was deficit neutral in terms of our long-term fiscal health. It did things when the deal with translated to the appropriations process like ensure that there were double-digit percentage increases off of sequester for key things like infrastructure and TIGER grants.

The deal also led to things like progress on making sure that States can get started on a process to get universal preschool. So across the board—and in our national security it provided additional funding for defense. And so those are things it specifically did I think that impact our citizens and our businesses every day.

In addition to that, it is a process issue in terms of the certainty it provided, and I think we had a fall of much uncertainty, an uncertainty that caused damage to the Nation's economy and its citizens. And so the certainty I think is an important part of what it did as well.

I think finally in that area of process, what it did is it shows that we in Washington can start to build the muscles of working together to move things forward.

Chairman MURRAY. Can you also comment on the President's Opportunity, Growth, and Security Initiative and how you see that complementing the 2015 appropriations process?

Ms. BURWELL. I think "complement" is the right word. One of the things that we have done is, in the budget and in the 1,500-page appendix that accompanies it that came out today, you see how the President would fund priorities at the current 2015 levels, and so it is hopeful that yesterday when our budget came, the appropriations process can start and move forward. That was our objective; that was our goal.

As you also articulated, while everyone signed and believed in the deal and we put forth a proposal to live at those numbers, we believe those are not the right numbers to actually encourage the economic growth and job creation and opportunity we need as a nation. Therefore, what we have done is propose an initiative, and an initiative that would be fully paid for, to express what we think is a more and better path for the Nation.

Chairman MURRAY. Okay. Let me switch gears here really quick. I have been very clear in my conversations with you and the Department of Energy that I expect the Federal Government to meet its milestones at our defense environmental cleanup sites. That is really important to me as well as other Senators who sit on this Committee. Within your 2015 budget request, you cut environmental management by $135 million, with the Hanford-Richland operations getting about $100 million of that cut. I would like you to explain that justification, and with that reduction, what is the plan now to keep the legal commitments that have been made to communities like the tri-cities in my home State?

Ms. BURWELL. Senator, the legal commitments are something that are very important and the administration takes very seriously and has put forward a budget that we believe enables us to do that.

With regard to the cuts that are occurring, one of the things, a number of those programs are for pieces of work that have been completed.

Have said that, the administration is committed to making the progress we need in Hanford and the other areas that are funded there to do the cleanup that we need to do and work on that. That is a commitment that the administration has made and we will continue to work towards.

Chairman MURRAY. Well, we have really serious challenges in making progress at these nuclear cleanup sites across the country. We need a long-term sustainable plan for this, and I would like you and the Department of Energy to work with me to develop a long-term comprehensive plan to make sure that we are meeting the needs at these really incredibly important sites.

Ms. BURWELL. Senator, I look forward to doing that.

Chairman MURRAY. Okay. And I just have a few seconds left here. I wanted to ask you about the health care costs that we are seeing, the slowdown in Medicare per beneficiary spending. I have asked Dr. Elmendorf for his views on what is contributing to the decline in health care costs, particularly for Medicare. Can you just comment on that really quickly?

Ms. BURWELL. A number of things are contributing to that.

One, there were some things that were trending, that were trending down. We also saw some of the decline that has come from the slow growth of the economy, but most of that is now going away. And the Affordable Care Act is an important part of what is contributing to those slower growth levels. And what we try and do in this budget is build on that by doing additional cost savings in the health care space, which is one of the fundamental drivers of the deficit.

Chairman MURRAY. Okay. Thank you very much. My time is up. Senator Sessions?

Ms. BURWELL. Thank you, Madam Chairman.

Senator SESSIONS. Ms. Burwell, I think you have acknowledged plainly that the President's budget calls for spending on the discretionary side, $56 billion more than the Ryan-Murray bill that was passed about 10 weeks ago. Is that correct?

Ms. BURWELL. In a paid-for initiative.

Senator SESSIONS. The question is: Do you spend more than was agreed to in the spending limits of the Ryan-Murray bill?

Ms. BURWELL. We propose an initiative that would be paid for to do that.

Senator SESSIONS. And you would spend $56 billion more?

Ms. BURWELL. Only if paid for.

Senator SESSIONS. But do you not agree that the Ryan-Murray law did not say pay for, it simply limited the amount of spending, and you are spending over the amount that that bill allows to be spent?

Ms. BURWELL. Senator, when the caps were put in place—and I had the opportunity to work with the caps in the first round when I was at OMB—much of the why the caps were put in place was about deficit reduction. When—

Senator SESSIONS. No, you are talking about—you are theorizing about the purpose of it. The law limited spending, did it not, and you are spending over what the law requires?

Ms. BURWELL. Senator, only if the Congress would choose to pass a law that would alter that. Our budget comes in at the levels of—

Senator SESSIONS. So you are proposing that we alter Ryan-Murray so you can spend $56 billion more next year alone?

Ms. BURWELL. What we are proposing?

Senator SESSIONS. Yes or no? Is that correct?

Ms. BURWELL. We propose a paid-for—

Senator SESSIONS. Can't you answer that question simply yes or no? Do you propose to spend $56 billion more than Ryan-Murray allows, and you are proposing that we change Ryan-Murray to allow you to do so? Yes or no?

Ms. BURWELL. Senator, we do propose a change in the law that would be fully paid for that would invest in the things that we believe are necessary for the economic health of the Nation.

Senator SESSIONS. So you are spending $56 billion more, and you are going to raise taxes to pay for it, and you think that is acceptable?

Ms. BURWELL. Senator, we believe—

Senator SESSIONS. And I just want you to know—ask you to tell the American people, do you want to spend more than the President agreed to when he signed Ryan-Murray 10 weeks ago?

Ms. BURWELL. Senator, we signed Ryan-Murray—

Senator SESSIONS. You look real innocent the way you look at me here like you do not know what I am talking about. Can't you just simply answer the question? Yes or no, do you intend to spend more than Ryan-Murray? And will that not require an amending of the law to allow you to do so?

Ms. BURWELL. It will require an amending of the law.

Senator SESSIONS. And it will spend $56 billion more?

Ms. BURWELL. Not against the—

Senator SESSIONS. I am not talking about paid for. I am not talking about budgets. I am just saying, Are you spending more than the law allows currently?

Ms. BURWELL. Senator, it, I believe, makes a very big difference whether—

Senator SESSIONS. Why can't you say yes or no to that?

Ms. BURWELL. Senator, because I think that some questions are not simply yes-or-no questions.

Senator SESSIONS. Well, you have had your explanation. Now I am just asking yes or no—

Ms. BURWELL. Senator—

Senator SESSIONS. —are you spending more or less?

Ms. BURWELL. I think there are some questions that are not simply yes-or-no questions. Therefore—

Senator SESSIONS. This one is a yes-or-no question. You are refusing to answer it. I will answer it. The answer is that you are going to spend—you are asking us to raise the spending limits by changing the Ryan-Murray law so you can spend even more than you agreed to spend 10 weeks ago. And this is the way a nation goes broke. When we cannot adhere to our own spending agreements, then we get into financial trouble, and we end up with huge interest payments that we cannot afford, that are going to crowd out spending that we need to make in a dramatic way in the years to come as you well know. And I think that is important.

Now, you say that you have got a pro-growth tax reform and that that is going to increase revenues to the Government $300 billion for the transportation fund. That means you are going to raise taxes $300 billion, does it not?

Ms. BURWELL. Those are one-time transitional revenues.

Senator SESSIONS. And they will come from increased taxes so you can afford this spending.

Ms. BURWELL. They are one time, and that is why we have chosen to invest those in infrastructure.

Senator SESSIONS. Well, they are increased spending. Now, with regard to the interest on the debt, it is astounding to me, your own budget projects—OMB's numbers project that we would be spending—we spent last year $221 billion on interest, which is a huge sum for which we get nothing. And your budget projects that we would go to $812 billion in 1 year annual interest payment in 2024. Does that not threaten the financial future of America?

Ms. BURWELL. Senator, I agree with you, interest payments are not the most impactful way that we can use our dollars, our tax dollars as a nation, and that is why we need to be on a path to a declining debt-to-GDP ratio and a declining deficit-to-GDP ratio, which are now.

Senator SESSIONS. Well, not an impactful way to spend money—

Ms. BURWELL. Our budget—

Senator SESSIONS. —but it gets no real benefit, right, to pay interest on the debt?

Ms. BURWELL. Senator, our budget decreases the amount of interest we will pay on the debt by $236 billion.

Senator SESSIONS. The baseline budget that CBO gave us projected the interest would be $880 billion in the tenth year. You project $812 billion. The reason you project less I assume is because you have got $1 trillion in tax increases. But either way, doesn't this indicate that we have got to get our financial house in order because our future is threatened financially, as Dr. Elmendorf told us from that table a few weeks ago?

Ms. BURWELL. Senator, I think as we talk about our fiscal matters, we need to connect them to why we care about our fiscal matters, and that has to do with the health, the economic health of our Nation in terms of economic growth and jobs. And we think in the President's budget we have laid out a path that is the right path in terms of where the Nation needs to encourage growth and at the same time meet our fiscal responsibility.

What has happened in the numbers that you are appropriately reflecting, those numbers have grown over many, many years. There is a deep hole. There is a deep hole, and we have made good progress—

Senator SESSIONS. Well, when the President leaves office, he will have doubled the amount of debt of the United States of America, and he will be primarily responsible for at least half of it. And the President said in a statement a few days ago, this budget that you have prepared for us "adheres to the spending principles Members of both Houses of Congress have already agreed to." That is Ryan-Murray. It does not. Would you agree?

Ms. BURWELL. I am sorry. Our budget does not adhere to Ryan-Murray?

Senator SESSIONS. Right.

Ms. BURWELL. We do, because the document that has been put up shows fully how we will meet those levels.

Senator SESSIONS. It does not agree with Ryan-Murray. Forgive me.

Chairman MURRAY. Senator Baldwin.

Senator BALDWIN. Thank you, Chairman Murray and Ranking Member, for holding this. Welcome, Director Burwell, back to the Committee.

As I have begun to study the President's fiscal year 2015 budget, I think that there is a strong acknowledgment on behalf of the administration that we are facing deficits on several fronts and of several variations. While we are making our way to stabilizing our fiscal deficit, we are also facing an infrastructure deficit, an education and workforce development deficit, and a research and innovation deficit. And addressing these other deficits will help us out of our fiscal deficit because it sets the foundation, in my opinion, for long-term economic growth.

And for this reason, I am encouraged by the Opportunity, Growth, and Security Initiative in the President's budget, which I think makes the very investments that we need in order to move our economy forward.

I do want to actually focus on a couple of issues that are important to me as a Senator from the State of Wisconsin, some of which we have communicated about in the past.

On the positive side, Director Burwell, as you know, I wrote to you last year, late last year, requesting that the President's budget include a new plan to address the chronic problems of siphoning off funding that is intended for forest management and for fire prevention activities, and instead using them for wildfire suppression. I am encouraged that the President's budget treats our biggest fires as the true disasters that they really are by separating them out from the rest of the Forest Service management budget, and I think this is a good first step, and I look forward to continuing a dialogue on this issue. It has particular relevance to the State of Wisconsin and our northern forested area.

On a different note, I also want to make a comment about an issue that I was in communication with the administration about as the budget was developed, and that relates to a specific naval acquisition, the littoral combat ship. The Secretary of Defense has talked about a new vision, a pivot to facing the current day threats and the threats of tomorrow, and I frankly believe that this particular ship is very in tune with that change in direction, that pivot that we must take as a country. And while I have more overall supportiveness of the direction, I believe the proposal to truncate the purchase of littoral combat ships is shortsighted, especially given the direction of this administration.

Now, as to questions, the President's budget states that the race is on to ensure that the next wave of high-tech manufacturing jobs are created and happen here in America rather than overseas. The President's budget calls for the continued transformation of regions across the country into really global epicenters of advanced manufacturing by funding five new manufacturing innovations, sort of hubs, this year. And I strongly believe in this effort, and I know that in my travels around the State of Wisconsin, I can tell you that this is an effort that has been given strong support by private industry as well as public research universities.

So can you tell me how the President intends to roll out these next five institutes, how the selection will occur, and how these institutes fit into the President's overall manufacturing strategies?

Ms. BURWELL. So the institutes that will be coming online, some are in different categories. The Defense Department, as you know, has done one, and USDA will be doing one, and so different areas will be supporting the effort, and they will roll out one by one.

In the President's budget, the proposal—and you mentioned the Opportunity, Growth, and Security Initiative. That is where we would actually expand the number so that you could try and do 45 of these throughout the period of the next 10 years.

We think that encouraging this type of innovation, which brings together the private sector, our academic communities, and our communities themselves to encourage economic growth, is an important part of how we focus on growth and opportunity and jobs for the future. And so that is how it fits in the broader strategy.

Senator BALDWIN. Great. I notice I have just a couple of seconds left, but I want to note that the Department of Commerce has been an instrumental partner in the growth of a water technology cluster in the Milwaukee area known as the Water Council, and I hope that we can perhaps have a visit from you and others in the administration to see the fine work that is being done there.

I am going to be submitting some additional questions for the record as my time has expired.

Chairman MURRAY. Absolutely.

Chairman MURRAY. Senator Crapo.

Senator CRAPO. Thank you, Madam Chairman. And, Director Burwell, welcome.

Ms. BURWELL. Thank you.

Senator CRAPO. I want to spend my time trying to get some clarity on some of the numbers as we move through analyzing the budget. First, I wanted to return to the $56 billion in discretionary spending that Senator Sessions was discussing with you.

I understand the discussion you and Senator Sessions had. The question I have is: You indicated that $56 billion is fully paid for. I just would like to know, to be sure we are clear, how it is paid for. Is that in the tax revenue increases that are in the budget?

Ms. BURWELL. There are specific revenue areas in terms of what we think are loopholes, as well as mandatory spending cuts. So it is paid for both by spending cuts as well as revenue changes?

Senator CRAPO. And with regard to the revenue changes, the overall totals that I am seeing from the analysis that we have got is that if you look at the total number of revenue increases that are included in the budget, what I am seeing or what I am calculating is about $1.8 trillion over 10 years of new revenue. Is that correct? Does that square with your numbers?

Ms. BURWELL. I would not agree with the things that are included, and I think we could go back and forth on what is included in that number. For instance, things like immigration are counted on the revenue side, and that is because of the increased economic growth and productivity that is happening. So the revenue, immigration is counted in those numbers, but that is not what I think you would consider a policy change—

Senator CRAPO. If you took that, you would still be roughly over $1 trillion, then, wouldn't you?

Ms. BURWELL. Yes. Yes, around a trillion.

Senator CRAPO. So would you agree that leaving out the immigration revenue, there is roughly at least $1 trillion—again, roughly—of new tax revenue in the proposed budget?

Ms. BURWELL. Yes, and we would say that some of that we believe is revenue that relates to closing tax loopholes, that there has been bipartisan support for—

Senator CRAPO. Sure, and I understand that there is a lot of room there where we can discuss the loopholes. I just want to get the numbers right here.

By the way, with regard to the projected growth in the immigration reforms, I call that dynamic revenue—in other words, growing revenue as a result of growing the economy rather than just a straight tax increase. Would you agree with that?

Ms. BURWELL. No, in the way that CBO actually scored immigration. What CBO did was they scored a title of the bill, a very specific title of the bill that had growth in population, and while they did not—they did supplemental—

Senator CRAPO. Okay.

Ms. BURWELL. —efforts in terms of the scoring that would be related to what you would call "dynamic scoring," I think is the distinction that I would make.

Senator CRAPO. All right. I understand your distinction. Someday I want to get into it, with Congress and the administration, and get to using dynamic scoring. But that is not what I want to use the rest of my time on here.

You also said that you had in terms of the offsets in mandatory spending cuts, and I believe your number there is $402 billion in reductions in spending. Is that correct?

Ms. BURWELL. That is only the health care changes, and so that number does not reflect other mandatory changes such as those that are used to pay for the Opportunity, Growth, and Security Initiative, things like—

Senator CRAPO. Do you have a rough—

Ms. BURWELL. —crop insurance and other things.

Senator CRAPO. Okay. Do you have a rough estimate of what the total would be for all mandatory programs that you are counting?

Ms. BURWELL. I think what we are trying to do is put together, I think, the way we think about these spending numbers, which I think is what you are getting to in terms of the cut, is what we think about is in terms of there have been $3 trillion in deficit reduction from 2011 until now as the baseline. That is the baseline that was referred to in a number of others' comments. And then beyond that, when you add ours, the number goes to $5.3 trillion. When you take that number, the revenues to spending ratio is about 2:1.

Senator CRAPO. All right. Thank you. I appreciate that.

I want to go back to the $402 billion for the health care mandatory spending.

Ms. BURWELL. Yes.

Senator CRAPO. I have a problem seeing how you get there, but I think I have figured it out, and I want to be sure that I understand this. Did you not assume that there was a Medicare doc fix in the baseline?

Ms. BURWELL. We did assume that SGR is in the baseline.

Senator CRAPO. And, in my opinion—that is a $110 billion figure, approximately. In my opinion, that is an assumption that is not valid, or at least that it ought to be paid for or offset in the budget and would reduce that $402 billion claim that you are making for health care savings. And in addition, does not the budget propose to turn off the Medicare sequester from the Budget Control Act?

Ms. BURWELL. We do turn off the sequester in the out-years, yes.

Senator CRAPO. And that is another $140 billion of new spending. My point is it seems to me that both the cost of the Medicare doc fix and the cost of turning off the sequester in the Budget Control Act are expenses that we are going to have that are not offset against the $402 billion figure that you are talking about. Am I seeing that wrong?

Ms. BURWELL. So I think the way we think about those numbers is in terms of the overall, and—because I think what we are all talking about is trying to get to a declining deficit. I think that is the point that was made and has been made continually. And so when you get to those overall numbers, what we see is that the deficit as a percentage of GDP goes down to 1.6 percent, and as a percentage in terms of the debt to GDP, we see a declining—in 2015, we stabilize and then we decline to a number that is around 69 percent.

Senator CRAPO. I understand. My time is up, but I just do not see the $402 billion figure being accurate in terms of health care reforms if you offset those other appropriated expenditures. But we can talk about that at some other time.

Thank you.

Chairman MURRAY. Thank you.

Senator Warner?

Senator WARNER. Thank you, Madam Chairman. Thank you for the opportunity. And, Director Burwell, good to see you again.

I want to move the discussion a little bit over to an area that I think we are all going to have to grapple with. My good friend Senator Crapo and I spent a lot of time talking about, in our efforts around debt and deficit reform, infrastructure. I commend the President for making a request for $150 billion over 4 years. How we do that, whether it is involved in repatriation or some other item, I know we will talk more about.

I do believe that a permanent funding source of infrastructure, we are still struggling. We obviously rely upon a declining revenue source in the gas tax, and there is not a lot of appetite to grapple with that. But it is an area that I think needs a lot more examination.

One of the things that the President mentioned in his budget that I want to try to share with my colleagues is, with record low interest rates, it is—I think it would be a real mistake if we did not take advantage of trying to leverage private capital to help support infrastructure. And while the President in previous times had proposed an infrastructure bank, that did not go too far. I appreciate the fact that the President has kind of restructured part of his proposal and is talking about more of an infrastructure financing authority.

For example, I have got some legislation where there are five Republican cosponsors and another three that are looking at it quite a bit. It would recognize that we ought to leverage private capital in infrastructure. It would not include energy generation, but it would focus on road, rail, bridges, water, transmission. It would have private capital take first dollar loss. It would require that any project that would be financed would have to be investment grade. It is a more conservative version of what had been put out, proposed earlier. And, again, I mentioned that I start with five Republican cosponsors, five Democratic cosponsors, a number of other folks who are interested in it. And, you know, this would not replace TIFIA. It would be in supplement to TIFIA. We have got a major project in Virginia that just received TIFIA financing. It took a year for DOT to make that assessment.

The challenge on trying to leverage private capital into infrastructure is: One, TIFIA is a great initiative, but it is not a career path in DOT. We need long-term capital that is patient capital. We have lots and lots of American pension fund dollars that are going abroad because there are not enough projects here to finance because there is no financing mechanism.

Two, we need that backdrop that lowers the interest rates. A 200-basis-point interest rate can save $30 or $40 million on a 20-year or 30-year loan.

And, three, you need the expertise to be concentrated on infrastructure, to be able to have on the public sector side the ability to go toe to toe with Wall Street. There are lots and lots of public-private initiatives out and around the States these days. Some of them are good deals; some of them are very bad deals for the taxpayer. And I would simply—this is more a commercial than a question, and I apologize—say that as we come up on the Highway Trust Fund challenge, coming up around Labor Day, an infrastructure financing authority that would be initially capitalized at $10 billion or only scored at $7 billion, it becomes self-funding because of the fees that are charged. And while not a solution set and I do not want to oversell it because it does not replace the need for a permanent funding source, but—and let me also make clear that this is also something that is extraordinarily viable to smaller States because, even if you may only have a $30 million water project, you still might have a tranche of private financing that could be a part of that. And I would simply say that I am glad that the President has included this idea in his budget, and I just wondered if you might want to comment on that.

Ms. BURWELL. Well, I think probably the biggest comment I would have is the overarching importance of infrastructure. This is one piece of an overall approach to ensuring that we do fund our infrastructure, and I think funding for infrastructure has a number of dimensions to it in terms of, in the short term, the job creation that it can cause and create right now in terms of projects that are ready, moving those, and actually fixing things on the ground that are in need of repair across all sectors. You mentioned across all sectors, which I think is also very important.

I think the other thing that is important is us investing in our economy for the long term. A strong infrastructure, our manufacturing base—these are the kinds of things that I think we have to think about, not just today but they are the kinds of investments that we need to put in place so that 10, 15 years from now, we have the things in place that we have an economy that is competitive. Having come from the private sector and a company that uses those roads every day, the Walmart fleet is out every day. And so these are important issues for the overarching economy, so I would just second and emphasize the importance, that focusing on this is an important issue for jobs today, but it is also an important issue for us to think through the long term.

Senator WARNER. If I could just take 10 more seconds, I just want to say I concur because I believe this adds to our deficit. It will cost us more later than today, not to take advantage of these record-low interest rates. And to echo what Senator Sessions said—and I want to commend Chairman Murray for her good work on the budget—we bought ourselves a couple years, but at $17 trillion in debt, a 100-basis-point increase in interest rates adds $120 billion a year of, whether you view it as taxation or mandatory spending. That is the creation of two Homeland Security Departments each year with a 1-percent interest rate increase.

One of the things we do have to come back to after this 2-year budget is entitlement reform and tax reform.

Thank you, Madam Chair.

Chairman MURRAY. Thank you.

Senator Johnson?

Senator JOHNSON. Thank you, Madam Chair. Director Burwell, welcome back.

Ms. BURWELL. Thank you.

Senator JOHNSON. Thank you for your testimony, and also thank you for spending some time over the last year trying to work with us, with me, trying to define the problem and trying to look at areas of agreement.

I want to focus a little bit—I want to understand a little bit more about the difference between discretionary and mandatory spending in the proposed budget here. I want to focus on 2015 just so I get a good understanding.

The figures I have is that you are proposing in 2015 $3.9 trillion of spending; whereas, the CBO baseline would be about $3.78 trillion. So we are actually increasing total spending, total outlays by about $118 billion over the CBO baseline. Is that about right?

Ms. BURWELL. I think one of the things that we would want to look at in terms of why and where those increases are is how things are accounted for, whether those are CHIMPS, fees, any manner of things.

Senator JOHNSON. Which is always a problem, right.

Ms. BURWELL. Yes.

Senator JOHNSON. So, anyway, I guess the question I have—so $118 billion, $56 billion increase in discretionary spending, that would leave about $68 billion in some way, shape before scoring of mandatory spending. So the question I have is: Is the President or are you addressing the two-thirds of the budget, looking out 10 years in terms of the mandatory spending, in terms of reforming any of those types of programs—because what I am seeing in the first year is an increase in mandatory spending even though you are claiming a $400 billion savings over 10 years, for example, in the health care spending.

Ms. BURWELL. The mandatory savings do come as one moves out in terms of when they grow, and those savings in terms of those types of mandatory savings, when they are structural, as we have had the opportunity to discuss, those are the ones you want because they grow in the out-years. For instance, the—

Senator JOHNSON. So what structural changes are you proposing in this budget—

Ms. BURWELL. In terms of—

Senator JOHNSON. —two-thirds to the budget?

Ms. BURWELL. In terms of even just the implementation of the Affordable Care Act, when the Congressional Budget Office scores those numbers, in the second decade those numbers would be $1 trillion. You are starting to get into that in terms of now we have moved from 2010, so our budget window starts to get those. The $400 billion is within the window of changes that we do to Medicare, Medicaid, in terms of reducing those overarching health care costs.

Senator JOHNSON. We are getting really heart-wrenching e-mails and letters from our constituents. Their premiums are doubling and tripling. Their out-of-pocket maximums are increasing. They are making really heart-wrenching decisions, whether they have to quit a job so their income actually is lowered enough so they can qualify for subsidies and just be made whole because of increasing premiums.

Specifically you mentioned that health care spending is coming down because of the Affordable Care Act. Can you point to one thing that is actually causing health care spending to decline because of the Affordable Care Act, which just kicked in?

Ms. BURWELL. We have seen some of the changes in terms of some of the things that had been put in place in terms of incentives and spending in the Medicare space. Also, we have also seen it is both a quality measure but it is a cost measure; 130,000 fewer readmissions are occurring because of some of the standards that have been put in.

Senator JOHNSON. Okay. As you are well aware, as we were meeting over the year, I was really concerned about a 30-year budget window because we really have that demographic problem of the baby-boom generation retiring at the rate of 10,000 people per day.

Have you looked any further in terms of the 30-year problem that we are facing? I know we could never come to agreement in terms of what that 30-year deficit would be. Have you given any further thought to that or done any more work on that?

Ms. BURWELL. You know, one of the things that, when we think about those out-year numbers, I think is one of the most challenging—and you actually even see it in the 10-year window—is the question of the uncertainty when you get in those out-years in terms of the economic projections.

Senator JOHNSON. I understand.

Ms. BURWELL. And one of the things, I think, that is most challenging about those out-year numbers is we know what affects these numbers dramatically are the underlying economics, and whether it is the growth rate, the interest rates, any of those, and the level of uncertainty. And so we have focused our attention on trying to get the problem contained in those 10-year windows, continue to think about the out-year windows because that is when some of these very important costs come to bear.

One of the things we do know is the demographic bubble that you mentioned in terms of that Social Security. In the 10-year window, we are in the middle of some of the height of that. And so hopefully that will start to come down.

Senator JOHNSON. Well, speaking of Social Security, we are taking a look at that, and that is probably the best actuarial math we have. We are looking at between $13 and $15 trillion more in benefits being paid over the next 30 years versus payroll taxes being collected. That is pretty tough—some pretty tough numbers to look at in Social Security. The latest alternate fiscal scenario of CBO, when you take the percentage of GDP and convert those into dollars, shows a 30-year deficit, a total of about $127 trillion. So those are way larger than any projections we were talking to certainly in our discussions.

Talking about Social Security, because I tried to get you to answer this in your confirmation hearing, and now I have Doug Elmendorf. The trust fund holds about $2.6 trillion worth of bonds, U.S. bonds, right?

Ms. BURWELL. Yes.

Senator JOHNSON. And the Treasury has a $2.76 trillion liability because of those bonds, right?

Ms. BURWELL. Yes.

Senator JOHNSON. When you consolidate the Federal Government, what happens to the $2.76 trillion asset versus the $2.76 trillion liability? For the Federal Government that nets to what?

Ms. BURWELL. I think the question is whether those numbers are actually numbers that net. In terms of if one takes a balance—you know, a balance sheet and an income statement, you do not—the numbers—the way the numbers are—what the trust fund does—

Senator JOHNSON. Oh, but they—

Ms. BURWELL. —is represents those claims and what has been paid in. What the unified deficit does is represents what we owe. Both of those are relevant, important, part of transparent representations that are important.

Senator JOHNSON. I will refer you to your own—to OMB's publication that says that transaction nets to zero, and I would actually refer you to Doug Elmendorf's testimony where he also admitted that, yes, you have an asset, offset by a liability, and that nets to zero.

Thank you, Director. Thank you, Madam Chair.

Chairman MURRAY. Senator Merkley.

Senator MERKLEY. Thank you very much, Madam Chair.

In talking about the unified budget, I am looking at the budget total chart that is on 163 of your book. Do you have the budget with you?

Ms. BURWELL. Which table is it?

Senator MERKLEY. It is Table S.1.

Ms. BURWELL. Yes.

Senator MERKLEY. And just to be clear, this table includes the Social Security Trust Fund embedded within it, right? So as we look at these numbers, there is not some separate liability or concern that is on top of these. That is embedded inside of these numbers, yes?

Ms. BURWELL. Embedded within.

Senator MERKLEY. Okay. If we look at 2015 and we have a projected deficit of $564 billion, do you know how that compares to the Simpson-Bowles glide path that would have—the bipartisan plan that would have—what we would have for a deficit in 2015?

Ms. BURWELL. I do not know the specific number within Simpson-Bowles, but within Simpson-Bowles a number of the concepts and actual numbers and presentations are incorporated within our budget. One of the difference—and so much of it is embraced, and so I think they have not scored theirs against the new baselines that we have seen. So I do not know the exact number.

I think it probably also is important to reflect that there are places where we have a number of similarities. One place where we do have a difference is the issue of defense, and I think you know that in our current budget we replace sequester on the defense and nondefense side in the out-years. In addition, we proposed the Opportunity and Growth Initiative for this year.

Senator MERKLEY. Okay. Thank you. I will follow up and do those comparisons. It is helpful, because we had that bipartisan vision of a glide path to come back in fiscal responsibility. I do not think we are that far off—

Ms. BURWELL. No.

Senator MERKLEY. —from what was anticipated. And if we look at your projection for the year 2014 in that same chart, we basically see the debt held by the public drops to 69 percent of GDP. This has been a conversation in this room for year after year, since I came to the Senate, of the fact that we have to cap that debt as a percentage of GDP in order to avoid traveling into a declining spiral that would endanger our economy, particularly given the risk of potentially higher interest rates. And what you are presenting here is a plan that has addressed that and started to bring us back down in terms of our debt as a percentage of GDP.

Ms. BURWELL. That is correct and is in line with Simpson-Bowles in that the numbers that Simpson-Bowler, Rivlin-Domenici was about a $4 trillion number in total. Our budget produces about over a 5.3—it is $5.3 trillion in deficit reduction, so we are in that ballpark.

Senator MERKLEY. Do you know what interest rate is assumed for the 30-year Treasury bond by the end of this 2024 period?

Ms. BURWELL. No, not the exact number because the interest rate assumptions, you know, are on an annualized—they are on a year-by-year basis. But those interest rate assumptions are in line with the Fed and basically the Blue Chip in terms of our interest rate assumptions.

Senator MERKLEY. I appreciate that. I would be interested in running some sensitivity to variable interest rates, because it is something that is hard to predict, and one of the things we have been concerned about is our exposure if interest rates do go much higher. Some of the crises in the world have kept our interest lower than we might have anticipated, but maybe the world will be doing better and we will not be so lucky down the line. So that is why I was curious about that point.

I want to turn to the investment in infrastructure, particularly the inclusion of the $302 billion surface transportation reauthorization and the National Infrastructure Bank. And the multiplier for infrastructure is a pretty high multiplier, especially in an economy that has a shortage in construction projects currently. And I just want to applaud that. Everywhere I go in my 36 town halls every county, every year, folks are concerned about the state of the infrastructure, whether it is the fact that their local small port needs to be dredged or their local interchange needs to be expanded to be able to get onto the freeway, or so on and so forth.

It is strikingly of concern to me that Europe is spending 5 percent of its GDP on infrastructure and we are spending, I believe, about 2 percent. So thank you for including a vision for increasing our investment in infrastructure.

And, similarly, the importance that is placed on manufacturing in this budget, would you like to just comment on that?

Ms. BURWELL. Yes. As we discussed a little bit before, the importance of manufacturing and promoting manufacturing institutes or hubs that will help develop economies in local areas, as well as the technology that will help the U.S. remain a leader in this space. And so right now the plan is hopefully through implementation of the 2015 budget levels that you see presented in terms of meeting the Ryan-Murray levels, we will have an additional four and then hopefully an additional one in 2016.

As part of the Opportunity, Growth, and Security Initiative, we have proposed an additional funding that would get us to 45.

In addition, in the manufacturing space, the importance of the R&D tax credit is something that we also think the permanent extension of that would be an important part of promoting that economic growth.

Senator MERKLEY. And you have talked about these manufacturing research or promotion centers. How many of those are you going to locate in the State of Oregon?

Ms. BURWELL. It is a competitive process, as was reflected earlier.

Senator MERKLEY. Thank you, Director, for your testimony.

Chairman MURRAY. Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman. And thank you for your testimony. I am going to be a bit more specific, I think, than some of the others have been, because one area that I have been interested in and worked in a lot was this area of preschool. Of course, the President has proposed a Preschool for All Initiative to provide all low-and moderate-income 4-year-olds with access to high-quality preschool. And we all agree that funding invested in early education programs save the taxpayers later on.

So for a long time, the Federal Government has been doing a lot to increase access to these important programs, and they began in the War on Poverty in the 1960s and grew to 119 programs. I think at the present time there are 69 programs. And those programs have more money dedicated to them than we dedicate to kindergarten through 12th grade.

Now we are proposing another program. There has been a Government Performance and Results Act. It is not very well enforced. It is supposed to be enforced by the administration. That is where each agency, each one of these programs says what they are going to do, and then they evaluate how well they do it. And many of them are failing.

What used to be education programs and we are paying for as education programs are now often babysitting programs. There should be a difference in cost between babysitting and education.

When I was Chairman of the HELP Committee, we studied these programs, and Senator Kennedy and I were able to eliminate some of the overlap, some of the duplication, and change the course of some of the programs. But there are still 60 programs out there.

Was there any effort in your budget process to eliminate any of these other programs, to further eliminate some of the overlap? There is a lot of money out there. Could that cover the Preschool for All Program that the President is suggesting? Would the President's proposal be duplicative of Head Start or child care development block grants or some of the other programs that were authorized in No Child Left Behind, maybe even the Disabilities Education Act? Was there an attempt to eliminate some of those to fund this?

Ms. BURWELL. So a couple of points. One is GPRA Modernization, which is something that also I do—am familiar and I am glad that we will be submitting, as part of this budget cycle, the goals. This will be part of the implementation. When I was here before, there was GPRA. Since I came back, right before I came back, there is GPRA Modernization, and we will be submitting goals, cross-agency goals as well as the Department goals. So step forward, a lot of progress in that since I was here before, need to continue on it. I believe it is an important tool that we need to make use of in terms of management.

With regard to the specifics in the area that you are speaking to in terms of Head Start, preschool, and toddler and pre-K, yes, some of the things that we have considered. So one of the things we are doing to improve—you described, I think aptly, that there are some child care programs that are more babysitting but not focused on learning and skill development. And so as part of this effort, you will see these efforts not creating a new program, but connecting to early Head Start so that you build off of existing programs.

And so the issue of trying to make sure that we are aligning the work, there are a couple things we are trying to do: make sure you are not creating too many new things, do things within existing authorities, but also align with the States, because much of this work is done in the States, and we want to make sure that is a topic we all spend a lot of time on. And so we have tried to consider those in our proposals as we go forward.

With regard to the question of can you get enough cost savings to do that, I think you are familiar with the fact that, you know, even when done well, the programs—I do not know that we could get enough, but we are always looking for ideas and approaches to improve the way we do it.

Senator ENZI. Well, I hope there will be some emphasis on that.

My next question, similar to what Senator Warner said, in the last month the Congressional Budget Office estimated that spending on Medicaid is expected to increase by $574 billion, more than twice 2013, and Medicare will rise from $585 billion to $1.1 trillion by 2024. And over the next decade, spending for Social Security and Medicare, Medicaid, and the other major health programs will represent more than half of the Federal budget.

How does the President propose to make these programs sustainable in the long term when the bulk of the savings that you proposed includes reimbursement cuts and increased use of price controls on prescription drugs and that is not sustainable?

Ms. BURWELL. I think that we believe that many of the changes that we are proposing in that space—first of all, we come back to the point that I think part of the opening conversation was about, the importance of entitlement changes. Entitlement changes are actually quite difficult when one looks at changes to Medicare in order to meet the deficit numbers that we do. So even to get our $400 billion, I think what you are appropriately reflecting is choices have to be made that are difficult. And we believe we have made those choices on best information and things like the GAO and MedPAC's recommendations for where people are having overpayments. And some of those issues are in coding and a number of other places, and that is where we are basing our choices on in terms of what we believe.

With regard to the changes that have previously been done in a number of different areas, we still continue to see beneficiaries getting benefits in an appropriate way.

Senator ENZI. My point, though, is that those are one-time savings, and so it is not sustainable.

Thank you.

Chairman MURRAY. Senators Coons.

Senator COONS. Thank you, Chair Murray, and thank you, Director Burwell, for your hard work and for joining us here today. The administration in this budget has placed a real focus on economic growth and on job creation, which I think is appropriate and should be our highest priority as we continue to also find ways to achieve balanced deficit reduction and to improve our overall balance sheet as a country.

Which of the proposals in this budget do you think has the potential to create the most jobs and the best jobs?

Ms. BURWELL. I think that in terms of the issue of job creation, it is about the entirety of the budget in terms of there are things that are happening in the short term and things that are happening in the long term that are important, some of our fiscal responsibilities important to job creation in the long term, and certain things we are doing in the here and now.

I would focus on the here and now question with regard to infrastructure as an important place where I think we believe that the emphasis is important.

I think also we believe that research and development is another place where that is a more interim—is about the jobs that it creates now, but also the technologies that we develop and how that promotes economic growth is an important part in sort of the medium term as well.

Senator COONS. I agree, and I frankly also want to draw your attention to manufacturing, a sector I have focused on pretty heavily, that creates good jobs, high-quality jobs that have a great secondary benefit to the community. And there is one bill that I think may have been brought up by Senator Baldwin as well, or I have joined as Senators Brown and Blount as a cosponsor—

Ms. BURWELL. Yes.

Senator COONS. —that continues to advance this strategy of taking R&D and a skilled workforce and growing manufacturing and export opportunities and pulls them together into a regional hub or institute.

Tell me, if you would, about how these institutes will be rolled out going forward and why it is important to have it authorized by Congress.

Ms. BURWELL. I think we believe that congressional support in a bipartisan fashion, as you just described, is important from an authorization perspective. It will also be important as appropriations come in terms of how one funds these efforts over time.

In terms of how they will be rolled out, it is the plan to continue with the existing resources that there are to continue, and four have been announced. There will be others that will be announced over the period of the next 2 years. I think at this point in time we are hopeful that we can get nine of these done, but are hopeful that the funding would come to do 45, because as you articulated, we believe it is an important part of economic growth.

Senator COONS. My understanding is Germany currently has roughly 70 comparable manufacturing hubs or institutes, so if we could move from 2 to 4 to something like 40, I think that would be a great objective long term.

The long-term unemployed have particularly difficulty in rejoining the workforce and in transitioning back to work opportunities where they exist. Manufacturing employment, after significant, painful losses in the first 8, 9 years of this century, has come strongly back. There have been about 600,000 manufacturing sector jobs created over the last 4 years. And some studies suggest there are hundreds of thousands more that are currently unfilled because of a skills gap.

Tell me more, if you would, about the administration's strategy in this budget to make it easier for the long-term unemployed to find meaningful work.

Ms. BURWELL. There are a number of elements of that strategy, and it is a problem that we take seriously. It is actually a problem that is related to the long-term numbers with regard to productivity and growth.

In terms of what we hope to do is the President talked about a workforce strategy, and the Vice President is actively involved in it. There are a number of elements that I think are core to that.

First is ensuring that one pursues job training and skill training in a demand-driven or job-driven way, making sure that the training is matched to the needs of employers so we get a better match there. And then there is the question of doing high-quality training for those that are getting the training for those jobs and trying to put in place programs and best practices that do that. And so there are a number of steps that are part of that.

Credentialing is another element that we hope will be important to getting people to match with the skills.

Senator COONS. Well, and I know there has been great work done on the Workforce Investment Act reauthorization, streamlining it, focusing it. That is something I hope we will move on a bipartisan basis.

My last question. Ways and Means Chairman Camp recently released a tax reform proposal. This budget relies fairly heavily on tax reform in order to achieve both deficit reduction and new resources. Too often around here we focus on our differences, not our similarities. Are there any areas of commonality between Chairman Camp's proposals and the President's budget in terms of tax reform that you think we should focus on?

Ms. BURWELL. I think one of the similarities that is an important one is in a topic that we have had a lot of discussion on this morning, which is in the infrastructure space. Chairman Camp uses a similar approach to paying for infrastructure that we do in terms of those one-time transition revenues. I think that is a place.

The other place that I would highlight that there are re some similarities in the proposal would be in the offsets that Chairman Camp uses. There are a number of things that he proposes that are offsets that you will see in the President's budget. The out-year deficit numbers are deployment that would concern us in terms of the increases to the deficit in terms of a difference.

Senator COONS. Well, thank you. Thank you, Director.

Thank you, Madam Chair.

Chairman MURRAY. Thank you.

Senator Portman?

Senator PORTMAN. Thank you, Madam Chair, and, Ms. Burwell, good to have you back. Having sat in that seat, I know it is not always fun, although you seem to be having a pretty good time this morning.

I am, as you know, very disappointed in the budget, and it is for the simple reason that we are not addressing the fundamental issue we all know exists, and sitting in that very seat only a couple weeks ago was the nonpartisan Director of the nonpartisan Congressional Budget Office, telling us things are getting worse not better, telling us the deficit and debt projection over the next 10 years is worse not better, adding another $10 trillion to the debt.

One reason the debt went up another $1 trillion or so was because of slow economic growth, by the way, and he pointed out what is obvious, which is that the mandatory side of the budget, which is the part that is not appropriated every year, is growing, and it is already about two-thirds of the budget. He said it is going to be 77 percent of the budget, over three-quarters of the budget, in the next 10 years.

And he said basically the discretionary side, the part we do appropriate every year, the part Congress wrestles with, is going to be pretty flat as a percent of the economy. Revenues are going to go up, he said, not down. In fact, he said revenues are going to be up above their historic high within a year or so and then continue at that level. He said the problem is on the mandatory side. He said specifically the health care entitlements are going to grow by over 100 percent—over 100 percent.

So you know why I am disappointed, because this budget in a political year is a political document, and it avoids the tough choices, takes a punt, it chooses to punt on these tough issues. And, you know, I have talked about this, but I think the President has a great opportunity to lead on this, and he has chosen not to.

There are a lot of tax increases in here. There is over $1 trillion in new taxes. When you add that to the Obamacare taxes and the fiscal cliff, that means we would have added about $3 trillion in new taxes.

You are probably going to tell me, no, there is $400 billion in health savings. We can debate whether these savings are good policy or not. As I read it, about $350 billion of the $400 billion comes out of providers. And we have already heard from a lot of providers about those in Medicare and Medicaid who are less interested in providing those services because of the cuts to providers that we have already put in place.

But let us even assume that those savings, $400 billion, are appropriate. That would change the health care entitlement spending from being 115 percent growth over the next 10 years to 105 percent over the next 10 years based on your numbers. This means you are seeing more than a doubling of these important but unsustainable health care entitlements.

So, you know, I think, again, you are in a position to have to defend this, but I think anybody objectively looking at this would say, wow, it is just not responsive to the real problem that we have had laid out to us time and time again. Erskine Bowles also sat right where you are and said this problem of mandatory spending is the issue, and if we do not deal with this, we are facing the most predictable economic crisis in our country's history.

Let me ask you this specifically: Social Security Disability Fund is schedule to go bankrupt, as you know, in 2017. Nothing in the President's budget to save this program. Social Security Old Age

Program is schedule to go bankrupt in just 20 years; in other words, people who are retiring today are going to see these trust funds go belly up. And the trust funds are not what most Americans think they are, as you know. Most of us think of the trust fund actually having assets in it. We are going to have to borrow more or tax more or take spending from somewhere else in order to fund these trust funds. But even so, they go belly up.

The HI Trust Fund is scheduled to go bankrupt in 12 years. Nothing to save Medicare for generations to come in here. Again, understanding that there is $400 billion in these savings on the provider side. But those are not the long-term solutions that all of us know we must go to.

So I guess if this is the budget that truly reflects the President's vision for the future, as you have said, what are the President's plans for reforming and preserving these programs for future generations?

Ms. BURWELL. As we have discussed a lot this morning, at the root of the issue in terms of these numbers—and they are growing. We have a baby boom; it is retiring. That is a point of fact, and the room looks like it is about split in terms of, you know, people who are part of that, and some people here will be the echo—

Senator PORTMAN. I will not ask you to say who is on which side of that.

Ms. BURWELL. I will not. You notice I stopped.

[Laughter.]

Ms. BURWELL. You notice I stopped before I—

Senator GRAHAM. We are split on the high side, not the low side.

Senator PORTMAN. Yes, I think so.

Ms. BURWELL. I split before distinguishing between chairs. I looked around and thought it best not to do that.

Senator PORTMAN. So we agree there are 10,000 baby boomers retiring every day, and that is one of the things putting pressure on these programs.

Ms. BURWELL. It is putting pressure on the programs.

Senator PORTMAN. So why don't you address it?

Ms. BURWELL. The other thing that is putting pressure on the programs is health care costs, and I do not know if in your comment about health care and our reforms on the provider side if you were suggesting that the right way to approach it is to cut beneficiaries in the Medicare space in terms of beneficiary cuts.

Senator PORTMAN. Well, what do you think?

Ms. BURWELL. I think we have proposed what we believe is the right approach to handle—

Senator PORTMAN. Which is having these programs increase by over 100 percent over the next 10 years? Do you think that is sustainable?

Ms. BURWELL. The programs are going to increase because of numbers. The programs are going to increase because of rate of growth of cost—

Senator PORTMAN. So what do you—what happens when the trust funds go belly up, when they are insolvent?

Ms. BURWELL. What we are—

Senator PORTMAN. It is a 25-percent cut in people's Social Security benefits.

Ms. BURWELL. What we are doing is proposing what we—

Senator PORTMAN. Talk about beneficiaries. So you do not want to touch beneficiaries, but you want to be sure the beneficiaries take the brunt of this, because we refuse to do anything at this point—anything to deal with this—

Ms. BURWELL. There are premium increases—

Senator PORTMAN. —slow motion train wreck we see coming.

Ms. BURWELL. There are premium—in our Medicare approaches, there are a number of different things, and in addition, we believe actually that revenues are a part of the solution for the long term in terms of an ability to meet the numbers.

When one looks at the actual numbers, when one sits down—

Senator PORTMAN. So you would just continue to increase taxes, that is your solution?

Ms. BURWELL. Our solution is a combined proposal. If you look at deficit reduction in our budget, right now at the baseline, the CBO baseline since 2011, there has been about $3 trillion in deficit reduction. If you look at the proposals that we put in place, the number increases to 5.3. The ratio of spending to revenue in that is about 2:1. So we put much more burden on the spending side than on the revenue side.

Senator PORTMAN. We can have a longer discussion about the so-called savings, because when you increase spending at the same time you are doing things like the Ryan budget, which I supported—I will call it the "Murray-Ryan budget" here today.

Chairman MURRAY. Thank you.

[Laughter.]

Senator PORTMAN. You know, you are increasing spending in other places, and the fact is, again, you cannot escape this $10 trillion additional debt that CBO told us, sitting in that very chair, is going to occur, and the fact that these programs are not sustainable in their current form.

And I guess your answer today is we will just continue to tax more and more. We already have taxes as a percent of the economy going up to above the historic levels. And, you know, that is not me again. That is third-party nonpartisan Congressional Budget Office telling us that.

So I am disappointed in the budget, as you know. It does not surprise you. And I do hope that we can work together on some very small but positive aspects on the Medicare means testing side, because those stayed in the budget even though you took out your Social Security reforms during a political year, but on the—

Chairman MURRAY. Senator Portman, we need to move along here. We have got—

Senator PORTMAN. I am sorry. I was not looking at the time. My apologies. But I do hope we can work together on means testing under Part B and Part D, which I believe is still in the beginning.

Thank you, Madam Chair.

Chairman MURRAY. Thank you.

Senator Whitehouse?

Senator WHITEHOUSE. Thank you, Chairman. Welcome, Administrator Burwell. It is good to see you again.

I want to ask about health care, but before I do, let me point out, as you evaluate my colleagues' alarms about the debt and deficit, I think we should all bear in mind that those concerns seem to have an interesting characteristic, which is that they evaporate in proximity to billionaires and big corporations tax goodies. And if you raise the question of the low rates that hedge fund operators pay or offshoring tax schemes or special interest loopholes, well, we have got to protect those at all costs.

So when you hear these concerns about the debt and the deficit, do bear in mind that for a great number of my colleagues, the debt and the deficit is in practice much less important than protecting carried interest, much less important than maintaining Cayman Islands offshore shelters, and much less important than keeping big oil subsidies rolling. And I think that context is important in the context of this discussion.

I think we could get a lot done on the debt and the deficit if it was not more important to protect the carried interest loophole, to protect the big oil subsidies, and to protect offshoring in the Cayman Islands on the part of some of my colleagues.

You point out in your testimony that we have over $1 trillion in baseline reduction in Medicare and Medicaid, CMS. And when I look at your Table S.3, the cumulative deficit reduction that adds up all of the different steps that have been taken to reduce the deficit, I do not see that $1 trillion there.

Would it add to this in its practical effect on the deficit?

Ms. BURWELL. Because it is incorporated in the baseline, these numbers reflect everything. So it is in the baseline, and what S.3 reflects is in addition to the baseline.

Senator WHITEHOUSE. Additional. Well, if you are looking at the actual deficit—

Ms. BURWELL. So the savings that we see—so it would be reflected in the higher—in the upper bank of numbers.

Senator WHITEHOUSE. Yes, so it washes through this, but in practical effect, that $1 trillion does lower our out-year deficits and our liabilities.

Ms. BURWELL. It does.

Senator WHITEHOUSE. Okay. You have proposed a variety, the President has proposed a variety of reforms to Medicare and Medicaid that save a little over $410 billion, and most of that, as I think we have pointed out on both sides of the aisle here, is in the form of reduced payments to providers and pharmaceutical companies and so forth. There are only two that appear to be in the category of delivery system reform: one is bundled payments for post-acute care for $8.7 billion in savings, and the other is to have skilled nursing facilities contribute to the readmissions problem at $1.9 billion in savings. So that is a little over $10 billion out of total of over $400 billion in proposed savings.

I think that the delivery system reforms have much more potential than that. The Institute of Medicine has said it is $750 billion a year systemwide in potential savings. The Lewin Group puts it at $1 trillion a year in savings. You have got RAND with a new study that puts it somewhere between 700 and 900 at a midpoint, depending on how much you adjust for fraud. And I understand that there is a scoring problem with trying to get that into a document like this.

What concerns me is that the administration has never set a goal, it has never set a target, it has never set a concrete desire beyond bend the health care cost curve, which to me is kind of accountability free and meaningless.

So I would love to have the administration actually say, look, we cannot predict exactly what this is going to be, but we are in charge of this, and we are going to direct these changes, and we are going to force the bureaucracy to come up and try to—you know, meet a savings target.

Why would you not want to set a savings target in the context of such huge potential savings and such small actually identified savings in your budget?

Ms. BURWELL. In terms of making the kinds of changes in the system in terms of the health care delivery system, I think that is something that we are interested in, and you see some, as you reflect, perhaps not as aggressive as you are indicating that you believe we should be. I think we are open to those ideas.

With regard to the question of setting a specific goal, that would be something I would want to have the conversation with Secretary Sebelius, because I think the question of the delivery changes that you need and those savings and how that relates would be something that I would consider her more expert than myself in, in terms of what kinds of impact it would have in terms of the delivery system, in terms of what it provides for those in the system, individuals receiving care.

Senator WHITEHOUSE. Would you agree that bureaucracies tend to work better when they are given a specific goal to target rather than just operating without that?

Ms. BURWELL. I do believe that targets and goals are generally helpful things in terms of disciplining mechanisms. In this particular case, understanding the underlying changes and what it means to those receiving care is something I am just not close enough to to comment on this specific case, but in general take your point.

Senator WHITEHOUSE. Thank you.

Chairman MURRAY. Senator Graham.

Senator GRAHAM. Thank you, Madam Chairman. Welcome.

What percentage of GDP are we spending on defense in the President's proposed budget?

Ms. BURWELL. As a percentage of GDP, I know that in terms of the numbers that we are over $500 billion. In terms of our overall spending, it is about $3 trillion as a percentage of GDP. I would have to get back on the exact number.

Senator GRAHAM. Okay. Could you do me a favor and report back to the Committee—

Ms. BURWELL. Yes.

Senator GRAHAM. —the historical average of GDP spending on defense in times of peace and the historical average in times of conflict—and I know there are pretty wide variations there, depending on level of conflict—and give me the number we are spending. And when you look at sequestration, in year 10 of sequestration, if nothing changes, what percentage of GDP will we be spending on defense and compare the historical averages? Could you do that for us?

Ms. BURWELL. I would be happy to get it. I think it is reflective of why we believe that sequestration needs to be replaced, because we do not agree that those are the appropriate levels over the 10 years.

Senator GRAHAM. Do you agree with me that if nothing dramatically changes, President Obama will have added more debt held by the public on his watch than all Presidents combined before him?

Ms. BURWELL. Because we do not analyze it in terms of those numbers, you know, I have not done the historical averages in terms of adding all the numbers. When we think about this issue of the debt and the deficit, we think about where we are as a Nation and where we need to go and the slope of that line.

Senator GRAHAM. Well, where are we as a Nation?

Ms. BURWELL. Right now, in terms of debt to GDP, we are at a number that is in the 74 range, and this budget and these policies take us down to a range that is about 69. So it stabilizes in 2015, and then we decline to those numbers over time.

Senator GRAHAM. Over time does our deficit go up?

Ms. BURWELL. The deficit-to-GDP number actually goes down, and goes down to 1.6 in the end of the 10-year window in 2024. So it goes down as a percentage of GDP, which most economists and markets believe are the right—

Senator GRAHAM. Okay. When President Obama came into office, I think there was about $10.5 billion—trillion publicly held debt, 17 now. At the end of the 8 years—and this is all a guesstimate—could you report back to us whether or not the statement that on President Obama's watch his administration has added more publicly held debt than all previous Presidents combined? Could you report back to me and see if that is a true statement or not?

Ms. BURWELL. I would be happy to.

Ms. BURWELL. I think one of the important questions is, Why do we care about debt and deficit? And how—

Senator GRAHAM. Apparently we do not. None of us do. I am not just beating on you. Apparently none of us seem to be caring that much about it.

Let me ask you about the deficit and debt. Do you agree we need to adjust the age of retirement for Social Security and Medicare to sustain these programs over time?

Ms. BURWELL. What I believe is that we need to have a conversation and a bipartisan approach to thinking through the long-term issues with regard—

Senator GRAHAM. I am not asking you to unilaterally raise the age of retirement. I am not asking you to do that. I am asking you from—you are a very smart person. You are supposed to be telling the country the state of affairs through the budget. Is it fair to say to the American people that we as a Nation need to adjust the age of retirement for Medicare and Social Security because people are living a lot longer, there are fewer workers, and this is really driving our long-term debt?

Ms. BURWELL. At this time, in terms of our budget and what it reflects, our proposal reflects what we think are the better options to turn to in terms of reducing Medicare costs.

Senator GRAHAM. I am just asking you—you gave me a 10-year outlook here. It is a simple question. I mean, Ronald Reagan and

Tip O'Neill adjusted the age of retirement for Social Security back in the 1980s. Should we look at doing that yet again and harmonizing Medicare with the Social Security age retirement as a Nation? Should we be doing that, Republicans and Democrats?

Ms. BURWELL. I think the question is coming together on what are the first-order things that people should change. In our budget we propose what we believe are the first—

Senator GRAHAM. How about this as a good answer: Yes, we should. Republicans and Democrats need to make structural changes to entitlements. Ten thousand baby boomers a day are retiring. It is politically tough, but if you did it together, the country would be better off. So why don't we just admit that eventually we are going to have to adjust the age of retirement. We are going to have to change CPI and do some means testing to save these programs from oblivion. Is that not generally true?

Ms. BURWELL. On the means-testing point, I think you know it is in our budget. On the CPI issue, I think you know that while—

Senator GRAHAM. Is it generally true that entitlement reform has to be accompanied by revenue increases? It is called the "grand bargain," right?

Ms. BURWELL. We believe that you need both in order to meet the numbers.

Senator GRAHAM. So let us say that you had—you know, you got $600 billion in revenue increases about a year ago. You upped the tax rates. I do not know how much revenue is enough. If you took every dollar from every billionaire, would that balance the budget?

Ms. BURWELL. If you every dollar from every billionaire, would it balance the budget? I have not ever done that analysis.

Senator GRAHAM. Okay. Well, I will end with this thought: The flattening of the Tax Code, eliminating deductions for groups, billionaires, whatever group you want to include, I think is an exercise that Republicans have to embrace. And in return we have to have meaningful entitlement reform. My problem with your budget is that you eliminate deductions in the Tax Code and you do nothing on the entitlement reform structurally, nothing that really matters, and there will be no money left for the grand bargain.

So my disappointment is—and I will just end with this thought—that the President has got a couple of years left. After this election, he is still going to be President. I just hope we could sit down as a Nation, challenge the Republican Party to come up with a reasonable amount of revenue through Tax Code reform, and have the Democratic Party come up with some real structural changes to entitlements before it is too late. That would be a good legacy for the President. We will see what happens.

Do you agree with that general thought?

Ms. BURWELL. What I agree with is that I am still hopeful that the idea and concept of a larger bargain that goes beyond what we did to improve our discretionary spending, which I think Senator Portman mentioned, is, you know, we were able to make progress, some progress there, that that can happen. And I think part of why we believe that can happen is we reflected that the things that we put forward, we still stand by in our budget.

Senator SESSIONS. Senator Graham, would you yield just briefly? You would assume that that tax revenue increase would be used to save Social Security and Medicare, not spent on other things?

Senator GRAHAM. I would say this, Mr. Chairman, that Social Security and Medicare—Medicare is being heavily subsidized by the general treasury. Three out of four dollars, almost 60 percent at least, is coming from the general treasury. So I want to save Medicare from bankruptcy, and the reason we have long-term debt is the general treasury is going to be the funding source for Medicare. As to Social Security, eventually you get in that same boat. I am willing to put some of the revenue to retire debt to entice my Democratic friends to reform entitlements.

Chairman MURRAY. Thank you very much.

Senator King, you have been very patient. You will be the wrap-up questioner here.

Senator KING. Thank you. The good news, Administrator, is I am the last—but you have not heard my questions yet.

[Laughter.]

Senator KING. I am very interested in what Senator Graham just talked about, and I think it is a discussion that we should have and continue to have. I think one of the—the good news is we have got a budget, we have got a 2-year budget. The bad news is it has sort of lowered the level of intensity and interest in trying to find larger solutions to the longer-term problems, which, as has been pointed out today, generally do involve many of the mandatory spending programs.

A couple of short points. One is a lot of the discussion today of health care, and I think, frankly, some of the discussion is misplaced because it focuses, for example, on Medicare. What can we do to solve the health care cost that is driving Medicare. I think that is the wrong question, because if you focus on that question, inevitably you end up shifting those increasing costs to either the providers or the beneficiaries. There is no place else to go.

I believe that the emphasis ought to be lowering health care costs everywhere for everybody because it is a drag on our economy. As you know, we pay more than twice as much as anybody else in the world. Our results are 17th to 20th in the world, and it is just preposterous, the amount that we are paying for Medicare in light of what—I mean, for medical costs in light of what we are getting.

So I would urge the administration to continue to really look and work with us on structural changes, and there are promising results coming out of the Affordable Care Act. We are seeing in Maine a significant lowering in accountable organizations of emergency room visits and readmissions. They are a big savings, and that is where we need to be talking. You are nodding. I will take that as a yes.

Ms. BURWELL. Yes, that is. I mentioned the 130,000 reduction in readmissions earlier.

Senator KING. But that is where we have got to go, and to me the narrow focus on just Medicare is really misplaced. We have got to lower health care costs for everybody, and there is plenty of room to do it given what we see around the world.

Next question, different topic. Failing to support infrastructure is debt. It is debt just as sure as it is on the national books as the debt and deficit that we all talk about, and we are kidding ourselves if we beat our chests about lowering the deficit and lowering the debt if we are neglecting infrastructure because eventually it is going to have to be built, it is going to have to be repaired, and somebody is going to have to pay for it, and it is going to cost more money. Do you agree with that?

Ms. BURWELL. I agree. Pay now or pay later.

Senator KING. A different point, and that is, I am very concerned about interest and interest rates. And I think all of us are sort of whistling past the graveyard on that. If interest rates went back to 6 percent on the national debt, which it was in the year 2000, just the interest on the debt would be $1.02 trillion. If that number rings a bell, it should, because that is the amount of the budget that we just passed. In other words, the interest on the debt would equal the entire discretionary budget that was just passed in this body. And I believe we have to really be worried about that because we have been lulled by these low interest rates over the last few years.

I would like to ask your reaction to a proposal that would do tax reform. Everybody is talking about tax reform and where to get it. Chairman Camp and everybody else is. The difference is: What do we do with the money? And just like Senator Graham, I would invite my colleagues on the other side to talk about a tax reform package where the revenues were dedicated—I hate to use the term "lockbox." I am old enough to remember that ill use of a phrase—but were dedicated strictly to reducing the deficit. Because if we do not get those $17 trillion back, it is going to destroy our ability to do anything. It is going to eat up Pell grants, national parks, the defense budget, everything that we want to do around here.

Would you concur that there is some—how would you react to a proposal to do tax reform and dedicate it specifically to deficit reduction, not new spending?

Ms. BURWELL. So a large portion of our tax proposals actually are dedicated to deficit reduction, and you are right, that is the distinction. In terms of 600

Senator KING. But I am talking about a legal mechanism, not just precatory language.

Ms. BURWELL. Well, we team our—because we make clear where our tax offsets are used to pay for spending, the rest of our tax changes are dedicated to, as you are reflecting, deficit reduction. And I would also say, having been a part of the creation of the lockbox, when we had a balanced budget, that actually was the objective, is by using the construct of a lockbox, it went towards deficit reduction, which was about extending the life of the trusts.

Senator KING. Well, I think that is something that we really need to consider, because otherwise all of us, Democrats and Republicans and Independents, are going to be struck by the oncoming train of interest rates.

Finally, why don't we have a capital budget in the United States? It strikes me as odd that we equate building highways with paying park rangers, and we are borrowing for both. It seems to me it would make a lot more sense, we could understand our budgets better, if we had a capital budget and an operating budget. And then we could have a better—I do not mind borrowing for building highways and schools and bridges. I do mind borrowing to pay ongoing operating costs. And if we had that distinction in our budget, wouldn't everybody understand better what is going on?

Ms. BURWELL. You know, I am open to conversations about how to think and talk about budgeting. When one is thinking about capital budgeting, one of the things I think that is challenging is the question because we do not do multi-year commitments over a period of time in terms of how one pays back things. And so I think there are complexities in any of these things, whether it is capital budgeting or some of the other budgeting ideas. But as always, open to any conversation about understanding ways that you think you can get around—

Senator KING. I would urge you to think about that, because it is one thing to owe $17 trillion, the question is what do you owe it for and what part of that is legitimate capital, which future generations should help pay for because they are going to enjoy it. But future generations should not be paying our costs of the ongoing budget of the EPA or the FAA or that kind of thing. So I would urge you to give that some thought.

Thank you, Madam Chair.

Chairman MURRAY. Thank you. Thank you very much.

I want to thank all of our colleagues for participating today, and I especially want to thank you, Director Burwell, for your testimony and your responses and just let you know that the Committee really does appreciate the hard work that you and your staff put in on the budget and helping Congress with our work throughout the year.

As a reminder to all of our colleagues, additional statements or questions for Ms. Burwell are due in by 6:00 p.m. today.

And, finally, for the information of everyone, we will reconvene a week from today to hear from Treasury Secretary Jack Lew on the President's budget proposals within the Department of Treasury.

With that, this hearing—

Senator SESSIONS. Madam Chair, if we—the witness suggested maybe Secretary Sebelius could answer some questions. Maybe in the future we could have—Senator, maybe in the future we should have her here because her Department does impact the budget significantly.

Chairman MURRAY. Senator Ayotte, we were just going to call it to a close. I think the vote has been called. We will give you a few minutes here if Director Burwell is willing to stay.

Ms. BURWELL. Happy to, Madam Chairman.

Senator AYOTTE. Thank you, Director Burwell, and thank you for the last-minute run-in. We have had, as you know, a lot of hearings going on at once today, so I very much appreciate that.

I guess what I wanted to ask you about is this: The President's budget request seeks to improve the impact of Federal investments in STEM, which is obviously an important issue that we care about. And so we have had this outstanding GAO report out there that has talked about the overlapping and duplication in STEM programs, and essentially found that 83 percent of them are overlapping, also reporting that there was an inconsistency in figuring out which ones work best and what is the measurement of those.

So are you incorporating that in these budget requests? And do you plan to actually take up some of these GAO reports that, unfortunately, have been sitting on the shelf? Because it seems to me that is something that I hope we could agree on a priority on a bipartisan basis.

Ms. BURWELL. So in terms of the GAO reports, a couple of things.

First, in the specific area of STEM, there is STEM reform in this budget. It is proposed—we proposed it last year. It was not accepted by the Congress in terms of the changes that we proposed and the consolidations that we proposed. We have re-proposed it. We hope that it will gain support this year.

Second, in terms of the GAO, we have included GAO analytics in how we think about some of our Medicare changes in terms of places where they believe that there are over-expenditures, and some of that is in a number of places.

And so the last thing is in our cuts and consolidations, as we review those lists each year, some of those have been enacted, and we are pleased by that, and there is some alignment there with GAO.

Senator AYOTTE. Well, I think this is an area where I hope that you certainly would do more, because I believe that there is a whole host of areas—if I had a list—I am actually the cosponsor of the Duplication Elimination Act that is bipartisan, and essentially what it would require is for the executive branch, as a GAO report is issued, within a certain time frame to make the legislative recommendations to the Congress on implementing them. So, not just STEM areas but also we have seen duplication in areas of the Pentagon, we see duplication in areas of even drug prevention areas, which, I think is a very important mission, but you have got multiple agencies doing a lot of the same work. And, you know, there are lists of these areas, basically. And I am hoping that you will be more aggressive on that in terms of making proposals that will help us really review which programs are effective and which are not, and to make it actually easier to deal with the Federal Government on important issues.

Ms. BURWELL. And I hope that you will see that in the budget there are a number of areas in addition to STEM where we do that. And also hopefully you will also see an increase in the OMB–GAO conversations about not just in areas of duplication but other areas where the management function of OMB can build on some of the work of GAO.

Senator AYOTTE. So as I understand the President's budget proposal overall, we are still on the path to be at a point of close to $25 trillion in debt over the 10-year window. Is that true?

Ms. BURWELL. When we look at—I am not sure if you are using publicly held debt or just—we are at—

Senator AYOTTE. Right now we are at over $17 trillion, right? So as I look at the President's budget request, based on the amount of debt, where we would be in 2024 would be about $25 trillion, using that measure of right now what we understand, not unfunded liabilities, nothing like that.

Ms. BURWELL. So I think putting aside the question of gross or publicly held debt, I think what we believe is the most important measure is considering the debt in the context of the size of the economy, the debt to GDP. And as you look at the numbers in our budget and our policies, what we do is stabilize that debt-to-GDP ratio in 2015 and then take it on a declining path.

Senator AYOTTE. Well, I understand that measure, and certainly we could have a dispute over how we measure that total debt, unfunded liabilities. But I am just asking you this straightforward question. Even if you think the better measure is as compared to GDP, right now we are over $17 trillion in debt; by 2024, as I understand it, under this proposal we get to $25 trillion. Yes or no?

Ms. BURWELL. Yes, in terms of the measure that you are using.

Senator AYOTTE. Right. Well, that is the question that I asked with that measure, $25 trillion.

Ms. BURWELL. With that measure.

Senator AYOTTE. Yes. So as I view this budget, this is one that continues on the path that is dangerous for our Nation in terms of the fiscal challenges that we face as we see mandatory spending growing at even higher levels. So I think for us to get to $25 trillion in debt is not where this country should be, what the Nation should be, and certainly presents significant risks for us in terms of the fiscal challenges facing the Nation.

So we can dispute the measure, but I just want people out there to understand where we are going. It is not a downward trajectory. It is an upward trajectory.

Ms. BURWELL. Actually, I agree that helping folks understand the importance of these numbers is quite important. And when one thinks about the deficit, which is what contributes to the debt, that is on a downward trajectory. It has the steepest slope of decline that we have seen on a continuous basis since World War II. And as Nation, I think what the American people are most interested in is the tradeoffs that our fiscal policy is not about a number, it is actually about what it means for them in terms of economic growth, job creation, and people coming into the middle class. And when you have a decline that is the steepest slope that we have seen since World War II, I think the real question that we should be discussing is: Do you want that slope to be more steep? And if you do, what are the costs in terms of the deficits that were mentioned by your colleagues in terms of infrastructure and other things? And what does it mean for job creation and—

Senator AYOTTE. But, Director Burwell, do you dispute that the deficit goes up again?

Ms. BURWELL. In our budget window, all of our numbers, the debt to GDP and the deficit to GDP, are on a declining path.

Senator AYOTTE. You say declining. So the deficits under your proposal are going to continue going down?

Ms. BURWELL. That is—

Senator AYOTTE. In real numbers.

Ms. BURWELL. In terms of the debt to GDP, which over the—

Senator AYOTTE. No, not debt to GDP. In real numbers. In other words, I am not asking you debt to GDP. I am asking you if I have a $500 billion deficit this year, does it go to a $400 billion the next year, then $300 billion, then $200 billion? As I understand it, it actually increases—that you have actually a situation where—you have several years of declining deficits, but then you go back to increasing deficits.

Chairman MURRAY. Senator Ayotte, I am going to let Director Burwell answer, and we have votes, and we are going to have to adjourn.

Ms. BURWELL. The number stays—in terms of the number that we are at the beginning of the window, it is 564. At the end of the window it is $434 billion. During that period of time, it vacillates around a $503 billion level, but over the period of the trajectory, in real numbers, not as a debt to GDP or deficit to GDP, it is a decline.

Senator AYOTTE. Is there any point where there is no deficit?

Chairman MURRAY. Senator Ayotte, we are going to have to adjourn here, which we already did 5 minutes ago, but I appreciate, Director Burwell, you staying and really appreciate your testimony, and with that, we adjourn this Committee.

Ms. BURWELL. Thank you, Madam Chairman.

Senator AYOTTE. Thank you.

Chairman MURRAY. Thank you.

[Whereupon, at 11:54 a.m., the Committee was adjourned.]

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## Sen. Baldwin

**While recent headlines focus on California's drought, access to clean water is a national concern that spreads from the southeast to the plains states as well as my home state of Wisconsin. Nearly one in ten watersheds in the U.S. is considered "stressed," with demand exceeding its natural supply. While we are just beginning to grapple with the ramifications of water scarcity, access to clean fresh water is matter of survival in many parts of the world. Director Burwell, given these realities, do you believe a coordinated federal program or center of excellence would help advance and integrate the broadest range of multi-disciplinary science, engineering and policy that is being conducted in the U.S. concerning freshwater?**

The Administration agrees that current and ongoing efforts to address the effects of climate change, such as the availability of water supply, require a coordinated effort across the Federal government as well as with State, local, and tribal governments, and other stakeholders. As part of President's Climate Action Plan, the Administration created the National Drought Resilience Partnership, an interagency group designed to both help communities better prepare for future droughts and reduce the impact of drought events on livelihoods and the economy. Through the National Drought Resilience Partnership, communities will have easier access to Federal drought resources and information such as monitoring, forecasting and early warnings. The partnership will also seek to facilitate longer-term strategies to address water security in critical sectors such as agriculture, municipal water systems, energy, recreation, tourism and manufacturing. The National Disaster Recovery Framework and the Hurricane Sandy Task Force are two additional recent examples of the Federal government leading such a coordinated effort. The Administration will continue to seek such opportunities and will consider ways to encourage and institutionalize this type of approach across the Federal government.

## Sen. Baldwin

**My Next Generation Research Act (S. 1552) would coordinate efforts within the National Institutes of Health (NIH) to improve opportunities for our next generation of researchers. As a proud supporter of biomedical research, I was pleased to see the President's budget encourage and strengthen NIH's efforts to bolster our next generation of researchers. In FY 2015, to encourage exceptionally promising new investigators and to speed the transition of talented trainees to independent researcher positions, NIH will continue to emphasize programs such as the NIH Director's Early Independence Award, Transformative Research Award, and New Innovator Award, as well as the Pathway to Independence Award. NIH will also continue to implement a series of steps to enhance its effort to recruit and advance the careers of people traditionally underrepresented in the biomedical and behavioral research workforce. Such steps include providing relatively under-resourced institutions with opportunities to provide mentorship and resources to undergraduate students interested in pursuing a biomedical research career. Please explain how previous budget cuts have harmed medical research, particularly our new researchers, and how the Fiscal Year 2015 Budget provides more meaningful opportunities for our up-and-coming scientists.**

Sequestration in FY 2013 limited NIH's ability to fund some promising scientific research and affected the pace of the advances. Overall, sequestration reduced NIH funding by $1.55 billion. These reductions led NIH to decrease the number of new grants awards by about 750, compared to FY 2012. Due to sequestration, NIH also reduced non-competing continuation awards by up to 10 percent and did not raise training stipends for National Research Service Award recipients.

The FY 2015 President's Budget includes $30.2 billion for NIH in the base budget, $200 million above FY 2014, reflecting a strong commitment to biomedical research. In addition to supporting the discovery of lifesaving treatments and cures, the NIH Budget creates and sustains jobs that improve the American economy. The Opportunity, Growth, and Security Initiative includes an additional $970 million for NIH, bringing the total budget to $31.2 billion (the FY 2014 Budget request) or 4 percent above FY 2014. NIH is currently the largest funder of biomedical research in the world, and the work it supports and conducts leads to advances in the diagnosis, treatment, and prevention of disease. The FY 2015 President's Budget includes funding to support training opportunities for up-and-coming scientists. The Budget includes over $767 million, $14 million above FY 2014, for dedicated training grants and fellowships for graduate students and postdoctoral researchers and includes a 2 percent stipend increase for these trainees. NIH remains committed to supporting New Investigators on new, R01 equivalent awards at success rates comparable to those of established investigators submitting new applications.

NIH also supports talented junior scientists who have the intellect, scientific creativity, drive, and maturity to flourish independently without the need for traditional postdoctoral training. Two awards NIH uses to support early-career investigators are the NIH Director's Early Independence Award and the NIH Pathway to Independence Award. The Early Independence Award provides a way for some exceptional early-career investigators to skip postdoctoral training altogether and to begin independent research directly after completing their terminal degree, while the NIH Pathway to Independence Award is designed to facilitate a timely transition from a mentored postdoctoral research position to a stable research position with independent support at an earlier career stage than is currently the norm. Funding for these important programs is included in the FY 2015 Budget.

## Sen. Baldwin

**The bipartisan Quality Data, Quality Healthcare Act (S. 1758), which I introduced with Senator John Thune, would provide for greater access to Medicare claims data by reforming the Medicare Qualified Entity program. The legislation would: allow organizations receiving Medicare data to analyze and redistribute data to authorized subscribers, including insurers, health systems, employers, and physicians, so that subscribers can make more informed healthcare decisions; and permit those entities to charge a fee to their subscribers so that the organizations can conduct robust analyses to improve healthcare quality and reduce costs. I was pleased to see the President's budget support many of the reforms in the Quality Data, Quality Healthcare Act. Like S. 1758, the budget proposal would expand the scope of how qualified entities can use Medicare data. For example, entities would be allowed to use the data for fraud prevention activities and value-added analysis for physicians. In addition, qualified entities would be able to release raw claims data, instead of simply summary reports, to interested Medicare providers for care coordination and practice improvement. How would these policy reforms increase healthcare efficiency, improve quality, and reduce costs?**

The Affordable Care Act includes a provision that allows CMS to make Medicare Part A, B, or D claims data available to qualified entities for the purpose of publishing reports and evaluating the performance of providers and suppliers. The Budget proposal would expand the scope of how qualified entities can use Medicare data beyond simple performance measurement by: 1) permitting data use for fraud prevention activities and value-added analysis for physicians; and 2) allowing the release of raw claims data, instead of summary reports, to interested Medicare providers for care coordination and practice improvement.

An important step in improving healthcare quality and efficiency is the dissemination of robust, granular, practice pattern data to providers. Such data allows providers to understand the clinical and cost implications of their unique practice patterns, and provides a basis for comparison with best practices. This Budget proposal is consistent with increased interest in providing feedback to providers to facilitate improvement of healthcare quality and efficiency. Further, allowing qualified entities enhanced access to Medicare data will encourage their participation in the program, and development of tools to assist healthcare providers in initiatives to improve the quality and efficiency of their practice.

## Sen. King

**In keeping with President Obama's commitment to ending chronic homelessness by 2016, what does this budget request propose to do for those states seeing increases in chronic homelessness? How much could we have cut chronic homelessness -- a population that often incurs significant public costs -- if we hadn't engaged in sequestration during a recession?**

**Background - The President's budget request states that the total number of individuals experiencing chronic homelessness on a single night declined by 15.7% between 2010 and 2013 (page 92-93). During that same time period, 23 states saw their total chronic homeless population increase, while 36 states saw their total chronic homeless populations increase from 2012 to 2013. Between 2010 and 2013, 12 states have experienced increases in chronic homelessness of 20% or more. On the basis of HUD Point in Time data from 2013, Maine, my state, saw an approximately 80% increase in its chronic homeless population between 2007 and 2013.**

The 2015 Budget requests $2.4 billion for HUD Homeless Assistance Grants to maintain over 330,000 HUD-funded beds that assist the homeless nationwide and support an estimated 37,000 new permanent supportive housing units. These new units will be targeted to communities with the highest incidence of chronic homelessness to support the Administration's goal of ending chronic homelessness in 2016. Between 2010 and 2013, chronic homelessness on a national level has been reduced by 15.7 percent or over 17,000 individuals.

The Federal Strategic Plan to Prevent and End Homelessness calls for fundamental changes to how the Federal government and communities across the country respond to homelessness so that ultimately no individual sleeps on our Nation's streets, and that those facing homelessness have a clear pathway forward to quickly re-enter permanent housing and get the care they need. In States and communities across the country, especially those with the highest or increasing incidence of chronic homclessness, Federal agencies will continue to work together with local partners to build coordinated community-based systems for preventing and ending chronic homelessness. Through direct interaction with local communities, the Federal government can utilize data to better understand local needs and help localities better target homeless resources to support the goals of the Plan.

While the full impacts of sequestration will not be known for some time, HUD provided early estimates that the cuts to the Homeless Assistance Grants would lead states and localities to support 60,000 fewer homeless persons, including chronically homeless persons. To limit the impact of these cuts, HUD has continued to encourage its partners to prioritize the needs of chronically homeless individuals when allocating homeless resources and leverage mainstream resources to serve this highly vulnerable population.

## Sen. Graham

**Over the course of sixty years, the Department of Energy's (DOE) Savannah River Site (SRS) has developed an incredible knowledge of how to handle nuclear materials. This very specialized knowledge means that SRS can play an important role in a range of DOE work including nuclear nonproliferation and applied sciences. However, I am concerned that attempts by DOE to capitalize on this knowledge have been hindered by OMB. Specifically, OMB has prevented SRS from being competitive in DOE's Small Modular Reactor program, has held up reprogramming requests, and is preventing DOE from using H-canyon for nonproliferation work. Given that SRS is not a closure site, and DOE is very interested in using the site for work beyond the Office of Environmental Management's cleanup efforts, what steps are you taking to ensure tbat OMB plays a facilitating role in tbese efforts?**

I understand that the Savannah River site, including the national lab, has a range of capabilities that could be utilized for various programs and activities within the Department of Energy, other agencies, and the private sector. The Administration supports efforts, primarily through the Savannah River National Lab, to engage in multi-purpose research and development on small modular reactors, non-proliferation, and other activities using funds appropriated, or otherwise made available, for those purposes. However, it is also important that Defense Environmental Cleanup funding and management attention at the Savannah River site remain focused on radioactive waste disposal and environmental remediation. This essential focus has become more critical with the continuing cost increases and scheduled delays for construction of the Salt Waste Processing Facility, which has placed numerous legally enforceable cleanup milestones at risk. The Administration is focused on ensuring the cleanup mission progresses in a manner that protects the health, safety, and environment of the South Carolina community hosting the Savannah River site.

## Sen. Graham

**The budget request puts the Mixed Oxide (MOX) Fuel Fabrication Facility program in cold standby but does not terminate the program or fund alternatives. According to the U.S-Russia Plutonium Management and Disposition Agreement, MOX is the only acceptable disposition path for the American share of weapons grade plutonium. DOE is continuing to study MOX and alternatives. If it is decided that MOX continues to be the only viable disposition path for plutonium, how much will the delays caused by this budget request add to the program? How much would it cost the government to end the MOX program?**

The Administration remains committed to the agreements made related to plutonium management and disposition. However, the MOX Facility has had significant, unsustainable cost growth, from an estimated $1 billion of construction costs in 2002 to $7.8 billion today, and a MOX-based disposition program could have a total life cycle cost approaching $40 billion including cleanup. Of note, GAO (report GAO-14-231) recommended an analysis of the root causes of cost increases and highlighted the importance of reassessing the plutonium disposition options. DOE is currently evaluating costs and implementation of other plutonium disposition technologies and will continue to keep Congress apprised of the proposed path forward.

## Sen. Nelson

**In the chart summarizing projected costs and savings for FY 2015 Medicare legislative proposals, a line item suggesting a proposal to integrate the appeals process for Dual eligible beneficiaries is provided, but no further information on this proposal is given. Please expand further on this proposal. Will the budget also integrate discrepancies between the Medicare Part D process, and the rest of the Medicare program? Additionally, how, if at all, will the budget address current delays in the provider appeals process?**

Medicare and Medicaid have different appeals processes governed by different provisions of the Social Security Act, resulting in different requirements related to timeframes and limits, amounts in controversy, and levels of appeals. At times, these requirements may conflict and can result in confusion for beneficiaries and inefficiencies and administrative burdens for states and providers. This proposal provides authority for the Secretary to implement a streamlined appeals process to more efficiently integrate Medicare and Medicaid program rules and requirements. More detail on this proposal is included in CMS' Medicare-Medicaid Coordination Office Fiscal Year 2013 Report to Congress.

The Budget also invests in HHS programs that process Medicare appeals. The Budget provides $121 million to CMS Qualified Independent Contractors (+$33 million over 2014 Enacted), $100 million for the Office of Medicare Hearings and Appeals (+$18 million over 2014 Enacted), and $12.5 million for the Departmental Appeals Board (+$2 million over FY 2014 Enacted). These investments will help HHS manage the large increase in appeals seen in recent years.

## Sen. Nelson

**The budget includes additional funding for the Ryan White HIV/AIDS program, and proposes to consolidate funds from Part D of the program with Part C, to emphasize care across all vulnerable populations. In 2015, 50% of people with HIV/AIDS will be over the age of 50: how will the budget address and incorporate the needs of au Aging epidemic through this proposal?**

The FY 2015 Budget supports the central goals of the Ryan White HIV/AIDS Program, such as ensuring that individuals living with HIV, including those over the age of 50, have access to care and treatment and experience improved quality of life. For people living with HIV who obtain public or private health insurance, Ryan White funding will continue to support services generally not covered by insurance, but that play a central role in the provision of effective, complex, comprehensive care, such as intensive case management. The consolidation of Part C and D funding will reduce grant application and reporting burdens and enable Ryan White grantees (such as HIV medical clinics) to focus more time and resources on providing services, including those along the HIV care continuum. These services, while also generally not covered by insurance, are critical to ensuring that people living with HIV get linked to and retained into care and started on life-extending antiretroviral medications. According to HRSA client level data, individuals living with HIV who are 50 and older make up approximately one-third of all Ryan White clients. And between 2010 and 2011 the percentage of Ryan White clients over 50 increased from 32 to 34 percent. The Budget strengthens the Ryan White program so that it continues to support the needs of this unique and growing population of Ryan White clients.

## Sen. Nelson

**In December, the Senate Aging Committee held a hearing on recommendations to improve long-term care options for middle-class Americans. Several of the recommendations – such as changing Medicare's observation day status or looking at quality standards for Medicaid long-term care -- were endorsed by the bipartisan Long-Term Care Commission, which included three of the President's choices for commissioners. An additional area that the Aging Committee has discussed is to improve advance care planning options, a policy that the Centers for Medicare and Medicaid Services has looked at but failed to move forward. What are ways that the budget addresses these issues as well as helping middle-class families to plan for their long-term care needs?**

The Administration is fully supportive of efforts to improve long-term care options for middle-class Americans and has been closely monitoring the efforts of the Long-Term Care Commission. The Budget includes a proposal that will help ensure that Medicaid beneficiaries receive their long-term care services in the most appropriate setting through the extension of the Money Follows the Person Rebalancing demonstration to 2020 and allows youth and children in Psychiatric Residential Treatment Facilities to be eligible for home and community-based waiver services.

The FY 2015 Budget also provides $100 million over five years for Aging and Disability Resource Centers (ADRCs). ADRCs serve as community-level "one stop shop" entry points into long-term services and supports – including home and community-based services that can enable people to remain in their homes – for people of all ages and income levels, including those who have chronic conditions and disabilities.

## Sen. Nelson

**I applaud the $378 milliou in mandatory funding and $319 in discretionary funding to support CMS, HHS OIG, and the Department of Justice's efforts to fight fraud, waste and abuse. I know that these efforts often save more money than they cost. What kind of return are you expecting on this investment?**

The investments are designed to reduce the Medicare improper payment rate, support the Health Care Fraud Prevention & Enforcement Action Team (HEAT) initiative, and reduce Medicaid improper payment rates. The funding will also allow CMS to deploy innovative efforts that focus on improving the analysis and application of data, including state-of-the-art predictive modeling capabilities, in order to prevent potentially wasteful, abusive, or fraudulent payments before they occur. For every additional dollar spent on Health Care Fraud and Abuse Control (HCFAC) program integrity efforts, CMS actuaries conservatively estimate $1.50 is saved. The 3-year rolling average return on investment for HCFAC law enforcement activities to date is a record 8.1 to 1. From 1997 to 2013, programs supported by HCFAC have returned over $25.9 billion to the Medicare Trust Funds. In FY 2013 alone, $4.3 billion was recovered to Medicare, Medicaid, and other entities.

## Sen. Nelson

**In FY 13, CMS reported the highest improper payment rate in years. How are you going to hold HHS accountable for achieving results in reducing improper payments?**

CMS does not report an overall agency improper payment rate. Rather, HHS reports separate improper payment rates for traditional Medicare fee-for-service, the Medicare Advantage Program, and the Medicare Prescription Drug program, as well as Medicaid and CHIP. In FY 2013, we successfully reduced improper payment rates in Medicaid and Medicare Advantage (Part C). Furthermore, in FY 2013 the Centers for Medicare & Medicaid Services recovered more than $3.6 billion in Medicare Fee-For-Service (FFS) overpayments through payment recapture audits and other methods.

Despite these successes, it is clear more can be done to address improper payments in the Medicare program. The primary cause of improper payments is administrative and documentation errors, in large part due to insufficient documentation. While it may take time for providers to adjust their documentation practices to comply with newer policies designed to prevent fraud—which can lead to increases in improper payments—we are optimistic that ongoing outreach and education will help providers understand and comply with these new requirements.

## Sen. Sessions

**The President's FY 2015 budget request includes $1.759 trillion in higher revenues relative to OMB's current law baseline. This amount includes revenues that would accrue from the President's amnesty proposal. How much of the higher revenues is dedicated to federal trust funds, specifically the Social Security and Medicare trust funds? How much of that amount is attributable to amnesty? Please provide annual amounts in your answer to both of these questions.**

As part of a balanced deficit reduction plan, the President's Budget proposes to raise additional revenue from curbing high-income tax expenditures and closing tax loopholes. While the Budget also takes aggressive steps to cut spending and reform health programs, the reality is that – with the retirement of the Baby Boom generation already under way – we will need higher revenues to put debt on a declining path while making needed investments and maintaining our commitments to seniors and the vulnerable. Overall, the Budget increases revenues as a share of GDP to roughly their levels of the late 1990s, a period that saw rapid GDP, investment, and job growth and the only balanced budgets of the last 40 years.

In total, the 2015 Budget proposes receipts of $43,775 billion over the ten years, 2015-2024, compared with $41,973 billion in receipts in the adjusted baseline. This total includes the Administration's tax proposals, as well as the revenue effects of immigration reform and changes to mandatory programs that generate revenue for the government. The Budget's adjusted baseline receipts are $43 billion lower than the Balanced Budget and Emergency Deficit Control Act (BBEDCA) baseline (sometimes known as the "current law baseline"). This reduction in receipts is due to the assumed extension of certain tax credit provisions and is entirely in general fund receipts.

With respect to immigration reform, the 2015 Budget estimates include an allowance for comprehensive immigration reform based on the Congressional Budget Office (CBO) cost estimate for S. 744, which passed the Senate with bipartisan support on June 27, 2013. The Senate-passed bill includes provisions to increase border security, reform our broken legal immigration system, and create a path to legal status for current undocumented workers who pay a penalty and taxes, learn English, pass a background check, and go to the back of the line. The Budget incorporates the receipt effects of S. 744 as an allowance that would raise an additional $456 billion in revenue over the 10-year window.

With respect to Federal trust funds, we believe that taking measures to extend the solvency of trust funds is important, and the Budget takes steps to do just that. For example, the proposals in the President's Budget would extend the solvency of the Medicare Hospital Insurance Trust Fund by roughly five years. Looking at receipts specifically, $184 billion in additional receipts that would be deposited in trust funds. For the Social Security and Medicare trust funds, the Administration's proposals would increase 10-year receipts by a net $30 billion and $22 billion, respectively. While the allowance for immigration reform is not broken down by type of receipt, the Social Security Actuary has separately estimated that the Senate-passed immigration bill would reduce the 75-year Social Security shortfall by 8 percent, extending solvency by two years.

Effect of the Administration's Proposals on Receipts
(in billions of dollars)

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2015-19 | 2015-24 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Provisions extended in the adjusted baseline 1/ | --- | --- | --- | --- | -0.8 | -7.9 | -7.4 | -7.3 | -7.1 | -6.6 | -6.4 | -8.7 | -43.4 |
| Budget proposals | -2.9 | 86.9 | 110.6 | 154.5 | 178.5 | 168.9 | 181.7 | 200.5 | 218.4 | 242.0 | 260.0 | 699.5 | 1,802.2 |
| Total, relative to current law receipts | -2.9 | 86.9 | 110.6 | 154.5 | 177.8 | 161.0 | 174.2 | 193.3 | 211.3 | 235.5 | 253.7 | 690.8 | 1,758.8 |
| Effect of Budget proposals on Trust Fund receipts: | | | | | | | | | | | | | |
| Social Security | 0.0 | 2.1 | 3.0 | 1.6 | 1.7 | 2.7 | 3.0 | 3.3 | 3.8 | 4.1 | 4.5 | 11.1 | 29.7 |
| Medicare | 0.0 | 0.7 | 1.4 | 1.7 | 1.9 | 2.3 | 2.4 | 2.6 | 2.8 | 3.0 | 3.2 | 8.0 | 22.1 |
| Unemployment Insurance | --- | -2.0 | -2.0 | 13.6 | 15.5 | 10.7 | 11.1 | 12.1 | 10.9 | 12.1 | 10.7 | 35.7 | 92.7 |
| Transportation | --- | -0.0 | -0.0 | -0.0 | -0.0 | -0.0 | -0.0 | -0.0 | -0.0 | -0.0 | -0.0 | -0.0 | -0.0 |
| Airport and airway | --- | 1.0 | 1.0 | 1.1 | 1.1 | 1.1 | 1.2 | 1.2 | 1.2 | 1.3 | 1.3 | 5.2 | 11.4 |
| Inland waterway | --- | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.5 | 1.1 |
| Hazardous substance superfund | --- | 1.8 | 2.5 | 2.6 | 2.6 | 2.7 | 2.7 | 2.7 | 2.8 | 2.8 | 2.9 | 12.2 | 26.1 |
| Oil spill liability | --- | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 0.6 | 1.3 |
| Total, effect on Trust Fund receipts | 0.0 | 3.7 | 6.1 | 20.7 | 23.1 | 19.7 | 20.6 | 22.2 | 21.9 | 23.5 | 22.9 | 73.3 | 184.4 |
| Comprehensive immigration reform | --- | 2.0 | 12.0 | 28.0 | 39.0 | 45.0 | 47.0 | 55.0 | 64.0 | 77.0 | 87.0 | 126.0 | 456.0 |

1/ These provisions have no effect on Trust Fund receipts.

## Sen. Sessions

**The President's budget and your testimony both indicate that implementation of the Affordable Care Act (ACA) is "one of the Administration's highest priorities" and that this budget "fully funds the on-going implementation" of the law. Please provide the cumulative amount spent to date on implementing the ACA. Please also provide these amounts sorted by mandatory and discretionary spending as well as by budget function and account, including any and all account transfers. In addition, please provide the total amount requested in the President's FY 2015 budget for implementing the ACA. Please also provide these amounts sorted by mandatory and discretionary spending as well as by budget function and account, including any and all account transfers. In addition, please provide the total amount requested in the President's FY 2015 budget for implementing the ACA. Please also provide these amounts sorted by mandatory and discretionary spending as well as by budget function and account, including any and all account transfers.**

The 2015 President's Budget requests $629 million in budget authority for Marketplace activities at the Department of Health and Human Services (HHS) and $452 million in budget authority for Marketplace activities at the Internal Revenue Service (IRS). HHS and IRS are the two main federal agencies charged with implementing the Marketplaces.

More broadly, ACA responsibilities are now a part of HHS's core mission and many activities cannot be disaggregated from base operations. We are able to break out the costs associated with CMS' Marketplace responsibilities. The table below is included in CMS' FY 2015 Budget Congressional Justification and reflects Marketplace spending since enactment of the ACA.

**ACA Implementation Spending**

*Dollars in Thousands*

| Marketplace Spending | FY 2010 | FY 2011 | FY 2012 | FY 2013 | FY 2014 Spending Plan 1/ | FY 2015 President's Budget |
|---|---|---|---|---|---|---|
| CMS Program Operations 2/ | | | $ 268,137 | $ 451,631 | $ 633,630 | $ 544,190 |
| CMS Federal Administration | | | $ 39,046 | $ 68,429 | $ 77,000 | $ 85,000 |
| Secretary's Transfer Authority | | | | $ 113,531 | $ 109,432 | |
| General Departmental Management | | $ 23,797 | | | | |
| Non-Recurring Expenses Fund | | | | $ 299,664 | $ 350,000 | |
| $1B Health Insurance Reform Implementation Fund 3/ | $ 4,654 | $ 99,620 | $ 20,943 | $ 158,471 | $ 20,000 | |
| Prevention and Public Health Fund 4/ | | | | $ 453,691 | | |
| Marketplace User Fees 5/ | | | | | $ 200,000 | $ 1,159,300 |
| Reinsurance Administrative Collections 6/ | | | | | | $ 20,300 |
| Risk Adjustment User Fees 7/ | | | | | | $ 20,400 |
| **Total Marketplace Funding** | **$ 4,654** | **$ 123,417** | **$ 328,126** | **$ 1,545,419** | **$ 1,390,062** | **$ 1,829,190** |

* FY 2010, FY 2011, FY 2012, and FY 2013 reflect actual obligations (as of 12/31/2013).
1/ Final FY 2014 Marketplace Spend Plan still under development.
2/ FY 2014 Reflects Marketplace budget authority, as well as $100 million in budget authority that was made available by offsetting base costs through Nonrecurring Expenses Fund obligations on non-Marketplace activities.
3/ Appropriated by Section 1005 of Public Law 111-152
4/ Appropriated by Section 4002 of Public Law 111-148
5/ Appropriated by Sections 1311 and 1321 of Public Law 111-148
6/ Appropriated by Section 1341 of Public Law 111-148
7/ Appropriated by Sections 1311 and 1343 of Public Law 111-148

## Sen. Sessions

**In a September 2013 memorandum, the Administration's own actuaries at the Centers of Medicare and Medicaid Services (CMS) explained that the recent slowdown in health care costs was unrelated to the President's health care law and that, in fact, the law worked against any improvements made to their projections of future health care spending since 2010. Have you read this CMS memorandum? In view of this CMS memorandum, please explain in detail the President's budget claim that the health care law is at all responsible for the recent slowdown in health care costs.**

Several different rigorous analyses have evaluated what has driven the recent slow growth in health care spending, and have generally concluded that, while the recession likely has depressed health care spending growth, health spending is low in historical terms even after accounting for the recession. These results suggest that a substantial portion of the recent slowdown is "structural," and thus likely to persist. As CBO Director Doug Elmendorf has said, the slowdown is partly due to the recession and "the loss of income in wealth, but we think that a significant part of that probably does not stem from the recessions, [and] probably arises from structural changes in the health care system."

The reforms in the Affordable Care Act (ACA) are a key component of these structural changes. The ACA created a foundation for bending the cost curve by reducing excessive Medicare payments to private insurers and providers, deploying new payment models that encourage more efficient, higher-quality care, and creating strong incentives for hospitals to reduce readmission rates. Effective implementation of these and other aspects of the ACA will play an important role in sustaining the slowdown in health care costs we are experiencing.

## Sen. Sessions

**Over the past year, the President has asserted on many occasions that he has proposed the same amount of health care savings, and Medicare savings, as the Bowles-Simpson fiscal commission. My Budget Committee staff has analyzed this claim, both with respect to the amount of proposed health care savings and Medicare savings, under every possible interpretation – looking at gross savings, net savings, savings over ten years, as well as savings in only the tenth year – and the statement appears to be false in every case. Does the administration believe the President's FY2015 budget proposes the same amount of health care savings, and Medicare savings, as the Bowles-Simpson Commission? If so, please provide my staff with the numerical basis for substantiating this claim.**

The statements you're referring to compared Medicare or total health savings at the beginning of the next decade under the President's FY 2013 Budget with the projected original savings under the Bowles-Simpson plan. Since that time, health care spending growth has fallen to the lowest levels since the Government started tracking these data in the 1960s. Compared with the 2011 Mid-Session Review, aggregate projected Federal health care spending between 2014 and 2020 has decreased by more than $1 trillion based on current budget estimates. Given the significant reduction in health spending that underpin the estimates, the scores of the Commission's proposals are out-of-date and do not provide a good point of comparison. However, the President's FY 2015 Budget strengthens Medicare, Medicaid, and other Federal health programs through targeted payment innovations and other reforms that encourage high-quality and efficient care and continue the progress of reducing cost growth. In total, these reforms would reduce deficits by $402 billion in the next decade and extend Medicare's solvency roughly five years.

## Sen. Sessions

**Similar to last year, the President's FY2015 budget includes a proposal to change the standard used for classifying Inpatient Rehabilitation Facilities (IRFs) in Medicare. Under current law, at least 60 percent of patients admitted must meet one or more of 13 designated severity conditions for a facility to be classified as an IRF. As you know, the budget includes a proposal to increase the 60 percent rule's threshold to 75 percent. I continue to have serious concerns about the impact this policy could have on patients' access to clinically appropriate care and also question whether the projected savings will actually materialize as more beneficiaries may be treated in higher cost settings. In developing its budget proposal, did the Administration consider alternative proposals, such as imposing a cap on the total amount of outlier payments made to each IRF, similar to what is currently done in home health? Will the Administration make a commitment to work with my staff on a more sensible policy than the one included in the President's budget?**

We believe the President's Budget policy to return the compliance threshold to its previous 75 percent level is the most appropriate classification criteria for IRFs. Returning to the 75 percent level assures that the higher payments IRFs receive from Medicare reflect the specialized rehabilitation care provided to patients with the most intensive needs. We look forward to working with Members of Congress and their staff on the President's Budget proposals.

## Sen. Sessions

**In a 2010 posting on the OMB Website titled "Discovering What Works;" former Director Zients suggested that policy initiatives should be supported by empirical evidence. Specifically, the post stated, "... too many programs have never been formally evaluated. And when they have, the results of those evaluations have not been fully taken into the decision-making process, at the level of either budgetary decisions or management practices." A recent HHS report found Head Start, the government's current pre-school initiative, is failing. Why is the Administration adamant about creating a new $66 billion pre-school program, when empirical evidence suggests that the program already in place is not working? Why is it more cost efficient to create a new program than reform the Head Start program that is already in place?**

Head Start is an important part of the Administration's overall strategy to provide children with a high-quality foundation that will prepare them for success in school and in life. The President's plan will maintain and build on current Head Start investments to support a greater share of infants, toddlers, and three-year olds, while partnering with States that are creating preschool opportunities for a greater share of four-year olds.

The Head Start program has also demonstrated substantial long-term impacts. As a recent report by the Council on Economic Advisers noted, research has shown that children served by Head Start are more likely to complete high school and attend college, have better health outcomes, and are less likely to commit a crime or become a teen parent. But the Administration is also committed to making Head Start an even stronger program, which is why we have launched reforms that, for the first time in the program's history, are identifying lower-performing grantees and ensuring that those failing to meet new, rigorous benchmarks must compete for continued federal funding.

The recent report by the Council on Economic Advisers can be found at the following website: http://www.whitehouse.gov/sites/default/files/docs/50th_anniversary_cea_report_-_final_post_embargo.pdf.

## Sen. Sessions

**Table S-3 of the OMB summary tables claims enacted reductions in overseas contingency operations (OCO) funding in the amount of $780 billion over the FY 2015-2024 period. Please provide a table, showing both budget authority and outlays, that reflects these OCO reductions. The amount spent on overseas contingency operations (OCO) has trended downwards in recent years as operations in Iraq and Afghanistan have come to a close or wound down. Counter to this trend, the President's budget requests $5.9 billion for OCO funding at the State Department for FY 2015, which is $2.1 billion more than the requested amount last year. How does the administration justify this increase? What are the parameters that are beiug used to determine which funding will be designated as OCO? Have these parameters changed in recent years?**

In response to the first part of your question, the attached table compares baseline budget authority and outlays for Overseas Contingency Operations (OCO) prior to 2012 appropriations with the current baseline from the 2015 Budget. Adjusting for small technical reestimates in OCO BA and outlays, the enacted reductions in OCO in 2012, 2013, and 2014 appropriations reduced budget authority by $807 billion over 2015-2024 and reduced outlays by $781 billion over that period.

In response to the second part of your question, the OCO request of $5.9 billion for the Department of State and USAID allows the Department to deal with extraordinary activities and contingencies that are critical to immediate U.S. national security objectives without unnecessarily undermining funding for longer-term efforts to sustain global order and tackle transnational challenges. The Administration's FY 2015 request for State Department OCO funding is $4.9 billion below FY 2013 operating levels and $0.6 billion less than the FY 2014 enacted level. While the number of accounts and countries being proposed for use of OCO is greater than the Administration has requested in the past, OCO is targeted toward meeting the extraordinary funding needs for operations and assistance in Iraq, Afghanistan, and Pakistan. It also supports our response to ongoing challenges presented by the Syria crisis, particularly the extraordinary humanitarian needs, and funds certain peacekeeping costs, including a new Peacekeeping Response Mechanism (PKRM). The PKRM is designed to respond to rapidly changing unanticipated peacekeeping requirements (without eroding ongoing, planned peacekeeping activities) until they can be budgeted for through the normal process.

**Cumulative OCO Savings**
(In billions of dollars)

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | '15-'24 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2011 enacted appropriations: | | | | | | | | | | | | | | |
| BA............ | 161 | 164 | 167 | 170 | 173 | 176 | 179 | 182 | 185 | 189 | 192 | 196 | 199 | 1,840 |
| OL............ | 97 | 148 | 158 | 165 | 169 | 172 | 176 | 179 | 182 | 185 | 189 | 192 | 196 | 1,805 |
| Savings enacted in 2012, 2013, and 2014 appropriations: | | | | | | | | | | | | | | |
| BA............ | -35 | -64 | -75 | -76 | -77 | -78 | -79 | -80 | -81 | -82 | -83 | -84 | -85 | -807 |
| OL............ | -20 | -49 | -53 | -66 | -74 | -76 | -78 | -78 | -80 | -81 | -82 | -83 | -83 | -781 |
| Technical reestimates: | | | | | | | | | | | | | | |
| BA............ | --- | --- | --- | 0 | 0 | 0 | -0 | -0 | -0 | -1 | -1 | -1 | -1 | -3 |
| OL............ | --- | --- | -3 | -3 | -1 | -0 | -0 | -1 | -1 | -1 | -1 | -1 | -1 | -10 |
| 2015 Budget baseline: | | | | | | | | | | | | | | |
| BA............ | 127 | 100 | 92 | 94 | 95 | 97 | 100 | 102 | 104 | 106 | 108 | 111 | 113 | 1,029 |
| OL............ | 77 | 99 | 102 | 96 | 94 | 96 | 98 | 100 | 102 | 104 | 106 | 109 | 111 | 1,014 |

## Sen. Sessions

**When CBO scored the new farm bill, it used outdated commodity prices. Shortly thereafter, recent USDA estimates showed significant declines in some commodity prices, meaning the farm bill's costs could be far greater. The CBO is expected to have a new score of the bill in March. Does the President's budget take into account the adjusted commodity price projections?**

The President's Budget estimates were based on more recent commodity price projections than those that CBO used to score the new farm bill. The President's Budget estimates are based on the prices published in USDA's November 8, 2013 World Agricultural Supply and Demand Estimates (WASDE) publication, while CBO's estimates were based on price assumptions from the February 8, 2013 WASDE.

## Sen. Sessions

**CBO recently argued that spending on the major health entitlements and Social Security are the principal drivers of federal debt. Now and going forward, federal revenues are actually projected to exceed historical averages as a share of GDP and thus aren't the problem. Appropriated spending is on a course to decline relative to GDP and thus isn't the main problem either. Given all that, describe your plans to restrain the growth of these big entitlement programs to rates that the underlying economy can keep up with.**

I agree that keeping Federal debt under control is an important part of our overall economic strategy to strengthen growth, job creation and opportunity. Under the President's leadership, the deficit has been cut in half as a share of the economy, the largest four-year deficit reduction since the demobilization from World War II. While making investments to grow the economy and expand opportunity, the Budget continues the progress in reducing deficits as a share of the economy, reaching 1.6 percent by 2024. It also stabilizes debt as a share of the economy by 2015 and puts it on a declining path after that. These reductions in debt relative to the economy are achieved with balanced deficit reduction proposals that restrain mandatory and discretionary spending, while raising additional revenue through tax reform that reduces tax expenditures for the highest income taxpayers and closes tax loopholes.

The Budget also calls for pro-growth immigration reform, which the Congressional Budget Office has found would increase economic growth and reduce the deficit by about $160 billion in the next decade and by almost $1 trillion over the next twenty years.

While addressing the primary long-term drivers of debt and deficits must be part of ensuring fiscal responsibility, the historical average levels of revenue and spending are the wrong fiscal targets for our Nation's future because of demographic shifts that are already underway.

Forty years ago, there were 3.4 workers for every Social Security beneficiary. Today, there are 2.8 and by the end of the current budget window the ratio will fall to 2.4. Inevitably, this means that the commitments for our largest entitlement programs will be greater than they were in earlier historical periods. We can't repeal these demographics.

That said, the President's Budget presents serious and substantial reforms to address the issue of health care cost growth. It includes more than $400 billion in health savings. These proposals, together with the cost controls already enacted in the Affordable Care Act, will significantly reduce future growth in health care costs.

The President also believes we need to work in a bipartisan fashion to strengthen Social Security -- just as happened in 1983, under the leadership of then-President Reagan and House Speaker Tip O'Neill. The President has laid out six principles for strengthening Social Security that should be the basis for any bipartisan reform:

- Any reform should strengthen Social Security for future generations and restore long-term solvency.
- The Administration will oppose any measures that privatize or weaken the Social Security system.
- While all measures to strengthen solvency should be on the table, the Administration will not accept an approach that slashes benefits for future generations.
- No current beneficiaries should see their basic benefits reduced.
- Reform should strengthen retirement security for the most vulnerable, including low-income seniors.
- Reform should maintain robust disability and survivors' benefits.

## Sen. Sessions

**According to the Social Security actuaries, replacing the current CPI with the chained-CPI would slightly improve Social Security finances, but the program's shortfall would still be substantially larger than it was when President Obama took office. The program's long-term financial outlook has grown worse every year. This is in part due to the slow economic recovery. If the new taxes and regulations from the ACA are hindering employment growth, the Social Security program finances will only worsen faster than the trustees now estimate. Even with CPI reform, the program's shortfall would still be larger than it was as recently as 2010. The program's current long-term shortfall is also substantially larger than the one that the landmark 1983 Social Security reforms averted.**

**a. Does the Administration believe that Chained-CPI is a more accurate measure of general price inflation?**

**b. Now that the President has backed away from even CPI reform, what is the Administration proposing to do to avert a financing crisis in Social Security before it becomes too large and too near to correct?**

**c. What does the Administration propose to do about Social Security disability's pending insolvency?**

The President always made clear that the chained CPI was not his preferred approach to deficit reduction but was included in the Budget to underscore the President's willingness to accept it as part of a compromise that also included substantial revenue. And the President remains open to accepting this proposal in the context of such a compromise. This year's Budget focuses squarely on the key drivers of our long-term fiscal challenges, achieving deficit reduction through health, tax, and immigration reform.

The President continues to believe we need to work in a bipartisan fashion to strengthen Social Security, as was done in 1983, under the leadership of President Reagan and House Speaker O'Neill. He has laid out six principles for strengthening Social Security that should be the basis for any bipartisan reform:

- Any reform should strengthen Social Security for future generations and restore long-term solvency.
- The Administration will oppose any measures that privatize or weaken the Social Security system.
- While all measures to strengthen solvency should be on the table, the Administration will not accept an approach that slashes benefits for future generations.
- No current beneficiaries should see their basic benefits reduced.
- Reform should strengthen retirement security for the most vulnerable, including low-income seniors.
- Reform should maintain robust disability and survivors' benefits.

To avoid DI trust fund reserve depletion, the Administration believes Congress must take action, as it has in the past, to reallocate the payroll tax rate between the OASI and DI trust funds. This would prevent a deep and abrupt cut in benefits for vulnerable people with disabilities. The Administration also urges Congress to take action to strengthen the DI program. This includes fully funding Continuing Disability Reviews, to ensure that only those eligible for benefits continue to receive them. We are also seeking support for early intervention demonstrations, so that we can identify effective ways to help people with significant disabilities succeed in the workforce.

## Sen. Wicker

**On page 40 of the President's budget proposal, he outlines a plan to reduce the government's role in the Tennessee Valley Authority (TVA). From the budget:**

***Reforming TVA. Since its creation in the 1930s during the Great Depression, the Federally-owned and operated Tennessee Valley Authority (TVA) has been producing electricity and managing natural resources for a large portion of the Southeastern United States. TVA's power service territory includes most of Tennessee and parts of Alabama, Georgia, Kentucky, Mississippi, North Carolina and Virginia, covering 80,000 square miles and serving more than 9 million people. TVA is a self-financing Government corporation, funding operations through electricity sales and bond financing. The FY 2014 President's Budget announced the Administration's intentions to undertake a strategic review of options for addressing TVA's financial situation, including the possible divestiture of TVA. Since then, TVA has undergone a major internal review and taken significant steps to improve its future operating and financial performance. In addition, TVA has committed to resolve its capital financing constraints. The Administration supports TVA's ongoing operating and financial initiatives and intends to closely monitor TVA's performance. The Administration continues to believe that reducing or eliminating the Federal Government's role in programs such as TVA, which have achieved their original objectives, can help mitigate risk to taxpayers. The Administration recognizes the important role TVA serves in the Tennessee Valley and stands ready to work with Congress and TVA's stakeholders to explore options to end Federal ties to TVA, including alternatives such as a transfer of ownership to state or local stakeholders.***

**1. Can you explain the Administration's process in its ongoing review of TVA's performance?**

**2. Do you agree that the Administration shall consult with Congress as well as TVA's stakeholders prior to pursuing any option to end Federal ties to TVA?**

1. The Administration has been working collaboratively with TVA through the strategic review announced in the 2014 President's Budget. The Administration supports TVA's ongoing operating and financial initiatives and intends to closely monitor TVA's performance, including the achievement of critical milestones contemplated in its financial plan. However, the Administration continues to believe that reducing or eliminating the Federal Government's future role in programs such as TVA, which have achieved their original objectives, may help mitigate risk to taxpayers. The Administration intends to partner with Congress and TVA's stakeholders to identify the most appropriate long-term path that mitigates taxpayer risk and meets the needs of the Tennessee Valley.

2. Yes. The Administration recognizes the important role TVA serves in the Tennessee Valley and understands the complexities associated with any changes in TVA's status. The Administration plans to engage with Congress and TVA's stakeholders on a longer-term solution for TVA.

## Sen. Graham

**[Followup requested during the hearing.] The historical average of GDP spending on defense in times of peace, and the historical average in times of conflict, and I know there are pretty wide variations there depending on what conflict, and give me the number we're spending. And when you look at sequestration, in year 10 of sequestration, if nothing changes, what percentage of GDP we'll be spending on defense. And compare that to historical averages. Could you do that for us?**

The attached table provides information on National defense outlays as a percentage of GDP from FY 1940 to FY 2013. This information is also included in the Historical Tables volume of the President's Budget (Table 6.1).

Average defense outlays as a percentage of GDP over this period were 7.5 percent. As you suggested, there has been wide variation in defense spending as a percentage of GDP over the last 75 years. For example, during World War II, defense spending peaked at 37.0 percent of GDP, the highest during the time period from FY 1940 through FY 2013. The lowest was 1.7 percent of GDP, which occurred in FY 1940, just prior to World War II.

However, measuring defense spending relative to GDP may not be the best benchmark, as spending on national security should be based on the circumstances and needs of the time. Measuring defense spending in constant (inflation-adjusted) dollars provides an alternative perspective. The attached chart shows defense outlays since 1940 in constant dollars and as a percent of GDP. While the long-term trend of defense outlays as a percent of GDP is steadily downward over this period, in real terms the trend has been level or gradually upward, with variation on both measures associated with periods of major conflict.

In the 2015 Budget's adjusted baseline, defense spending as a percent of GDP is estimated at 3.3 percent in FY 2014, declining to 2.4 percent by FY 2021 (the final year of Joint Committee enforcement). By comparison, under 2015 Budget policy, base budget defense spending is the same 3.3 percent in FY 2014 and 2.5 percent by FY 2021. These estimates exclude OCO funds, so a direct comparison to historical figures would be incomplete.

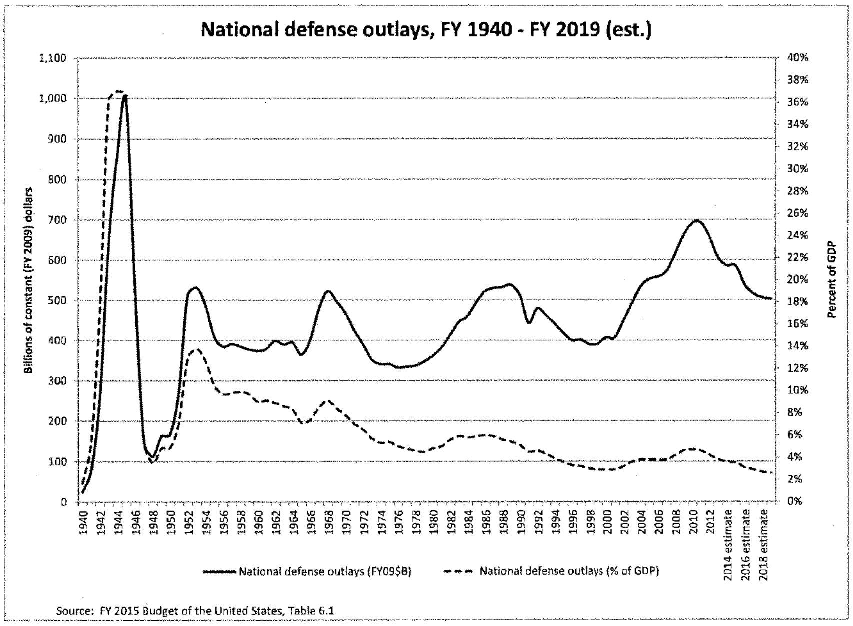
The Administration plans to submit details of the DOD OCO request after making a determination on enduring force levels in Afghanistan. Therefore, at this time, the Budget includes a placeholder of $79.4 billion for DOD's 2015 OCO budget authority (BA), equivalent to the FY 2014 request level. For FY 2016 through FY 2021, the Budget includes an annual placeholder of $29.9 billion for Government-wide OCO BA, including both the Department of Defense and the Department of State. This is consistent with the Administration's proposal to cap total OCO BA at $450 billion over the period from FY 2013 to FY 2021.

**NATIONAL DEFENSE OUTLAYS AS A PERCENT OF GDP**

| Fiscal Year | Percent of GDP |
|---|---|
| 1940 | 1.7 |
| 1941 | 5.5 |
| 1942 | 17.4 |
| 1943 | 36.1 |
| 1944 | 37.0 |
| 1945 | 36.6 |
| 1946 | 18.7 |
| 1947 | 5.4 |
| 1948 | 3.5 |
| 1949 | 4.8 |
| 1950 | 4.9 |
| 1951 | 7.2 |
| 1952 | 12.9 |
| 1953 | 13.8 |
| 1954 | 12.7 |
| 1955 | 10.5 |
| 1956 | 9.7 |
| 1957 | 9.8 |
| 1958 | 9.9 |
| 1959 | 9.7 |
| 1960 | 9.0 |
| 1961 | 9.1 |
| 1962 | 8.9 |
| 1963 | 8.6 |
| 1964 | 8.3 |
| 1965 | 7.1 |
| 1966 | 7.4 |
| 1967 | 8.5 |
| 1968 | 9.1 |
| 1969 | 8.4 |
| 1970 | 7.8 |
| 1971 | 7.0 |
| 1972 | 6.5 |
| 1973 | 5.7 |
| 1974 | 5.3 |
| 1975 | 5.4 |
| 1976 | 5.0 |
| 1977 | 4.8 |
| 1978 | 4.6 |
| 1979 | 4.5 |
| 1980 | 4.8 |
| 1981 | 5.0 |
| 1982 | 5.6 |
| 1983 | 5.9 |
| 1984 | 5.8 |
| 1985 | 5.9 |
| 1986 | 6.0 |
| 1987 | 5.9 |
| 1988 | 5.6 |
| 1989 | 5.4 |

**NATIONAL DEFENSE OUTLAYS AS A PERCENT OF GDP**

| Fiscal Year | Percent of GDP |
|---|---|
| 1990 | 5.1 |
| 1991 | 4.5 |
| 1992 | 4.6 |
| 1993 | 4.3 |
| 1994 | 3.9 |
| 1995 | 3.6 |
| 1996 | 3.3 |
| 1997 | 3.2 |
| 1998 | 3.0 |
| 1999 | 2.9 |
| 2000 | 2.9 |
| 2001 | 2.9 |
| 2002 | 3.2 |
| 2003 | 3.6 |
| 2004 | 3.8 |
| 2005 | 3.8 |
| 2006 | 3.8 |
| 2007 | 3.8 |
| 2008 | 4.2 |
| 2009 | 4.6 |
| 2010 | 4.7 |
| 2011 | 4.6 |
| 2012 | 4.2 |
| 2013 | 3.8 |
| **Average** | **7.5** |


National defense outlays, FY 1940 - FY 2019 (est.)
Billions of constant (FY 2009) dollars
Percent of GDP
National defense outlays (FY09$B)
National defense outlays (% of GDP)
Source: FY 2015 Budget of the United States, Table 6.1

# THE PRESIDENT'S FISCAL YEAR 2015 BUDGET AND REVENUE PROPOSALS

**WEDNESDAY, MARCH 12, 2014**

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
*Washington, D.C.*

The Committee met, pursuant to notice, at 10:02 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Whitehouse, Kaine, King, Sessions, Graham, Portman, and Toomey.

Staff Present: Evan T. Schatz, Majority Staff Director; and Eric M. Ueland, Minority Staff Director.

## OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. This hearing will come to order.

Secretary Lew, glad to have you here today. Thank you for all the important work you are doing to boost our economy and strengthen our middle class.

Thank you to my Ranking Member Senator Sessions and all of our colleagues who will be joining us today.

I want to just start by talking a few minutes about where we are today in terms of the budget and our economic outlook and why I think there should be some opportunities for bipartisanship when it comes to creating jobs and encouraging growth through our Tax Code.

We have a 2-year budget agreement in place, and we have taken the possibility of another fiscal crisis off the table through 2015. This was a very important step forward for families and businesses who expect some certainty from Washington. D.C.

But it cannot be the last step we take, because while the economy has come a long way since the Great Recession began in late 2007, we all know we are still not where we need to be. We need to do everything we can to get more people back on the job and build a foundation for broad-based economic growth now and in the future.

When it comes to our debt and deficits, we have also made a lot of progress over the last few years. Since August of 2010, we have put in place $3.3 trillion in deficit reduction. This year our deficit will be about a third of what the Congressional Budget Office expected it to be just 5 years ago, and the long-term outlook has improved somewhat as well.

But there is much more we will need to do to tackle our debt and deficits over the coming decades. As we are looking for ways to address each of these challenges—getting more Americans back to work and bringing down our debt over the long term—we are going to have to take a close look at our Tax Code because right now it is getting in the way. It is incentivizing activities that do not help growth in the United States, and we are missing opportunities to end wasteful spending in our Tax Code and bring down our long-term debt.

Our Tax Code is riddled with wasteful loopholes and special interest carveouts. In 2014 alone, tax expenditures, or the countless special tax breaks in our code, will cost us $1.4 trillion. That is more than we are expected to spend on Medicare, Medicaid, Social Security, or our national defense this year.

And far too many of these tax breaks are skewed to benefit the wealthiest Americans and biggest corporations, who need them the least. In other words, we are spending a lot of money through the Tax Code on wasteful and inefficient giveaways to people and businesses who do not need help, at a time when investing in better schools, infrastructure repairs, or medical research could strengthen our economy and help a lot of families who really do.

The good news is there are members on both sides of the aisle who would like to eliminate wasteful expenditures in our Tax Code. House Ways and Means Chairman Dave Camp recently released a new House Republican tax reform proposal that would get rid of many of them.

Now, I do have some serious concerns about Chairman Camp's plan. It puts every dollar of savings from closing loopholes back into lower rates, primarily for corporations and those at the top of the income scale, and continues to protect the wealthiest Americans and biggest corporations from paying their fair share toward reducing our deficit and boosting the economy.

Chairman Camp's plan does nothing to help tackle our long-term budget challenges and, in fact, depends on gimmicks just to stay deficit neutral over the next 10 years and would increase deficits in the decades beyond.

That is truly disappointing because the fact is, when you take a serious look at our debt and deficit in the coming decades, tax reform that does not help stabilize our debt is simply fiscally irresponsible.

But with that said, I am very pleased there appears to be some agreement about getting rid of wasteful, unfair tax loopholes. Chairman Camp would close a loophole—sometimes called the "John Edwards" or "Newt Gingrich" loophole—that enables some wealthy business owners to get out of contributing their fair share to Medicare and Social Security.

He would eliminate special tax breaks for oil companies and bring an end to Wall Street gaming in derivative contracts, which cheats taxpayers out of billions of dollars every year.

And Chairman Camp would close the carried interest loophole that allows hedge fund managers to pay lower taxes on their income than many middle-class Americans do.

These are just a few of the unfair special breaks that both Democrats and Republicans agree we need to eliminate. In fact, every one of these provisions also appears in the President's budget.

As we continue to work towards comprehensive tax reform, moving forward on any of them could help us do a lot to tackle our long-term debt challenges, and we could put some savings towards investments in job creation and economic growth.

One option I think there is a lot of interest in exploring is an expansion of the earned income tax credit, which President Obama proposed in his budget. The EITC helps lift millions of Americans out of poverty each year by rewarding work. But right now, workers who do not have children and workers whose children are no longer dependents are being left behind.

The President's proposal could really help them out because currently they are eligible for a maximum EITC that is only a tiny fraction of the maximum credit available to workers with dependent children.

President Obama's proposal would boost the credit for childless workers, further incentivizing work and expanding economic opportunity for more Americans who are trying to make ends meet.

To pay for it, President Obama would close a number of loopholes Chairman Camp also agrees we should close, like the carried interest loophole for hedge fund managers.

Chairman Camp unfortunately proposed cutting EITC in his plan, but many other Republicans and conservative experts agree it has been effective.

One expert from the American Enterprise Institute said recently, and I quote, "Look, I have been doing public policy since the 1970s, and this program worked."

Chairman Ryan said that the earned income tax credit "gives families flexibility" and "lets them take ownership of their lives."

The bottom line is there is bipartisan support for the EITC, and there is bipartisan support for closing the kinds of loopholes that could help us expand it to more struggling workers. So I hope my Republican colleagues will be interested in working with us on this because I think it is very critical.

Another issue I am going to be very focused on in the next few months, and I know a lot of our colleagues are as well, is making sure the Highway Trust Fund can pay its bills. The fund is facing a $60 billion shortfall over the next several years. As soon as mid-August, this could stall construction projects and put jobs across the country in jeopardy. If it is not resolved, it would place an unnecessary drag on our recovery this year and would put off much-needed repairs to our roads and bridges, costing us a lot more down the line.

So I was pleased both President Obama and Chairman Camp proposed using one-time corporate revenue to help tackle this fast-approaching infrastructure deficit.

In the past, both parties have been able to agree that repairing critical infrastructure is a good way to create jobs and encourage growth. Helping to create jobs here at home rather than letting corporations send them overseas to avoid paying taxes makes a lot of sense.

So between now and August, there is no reason we should not be able to work together on closing just a few corporate loopholes that both sides agree are unfair, in order to make sure planned repairs to our roads and bridges continue, and prevent any further hardship for workers in an industry that is just now getting back on its feet.

Now, even though closing wasteful loopholes is something many of us agree on, and even though many of us also agree that work incentives for struggling Americans and investments in our infrastructure make sense, I know moving the ball forward will not be easy.

Everyone here is well aware there are fundamental differences between our parties when it comes to making tax reforms. But as we saw in December, when both sides join together ready to make some tough choices and compromise, we really can deliver.

I think there are important opportunities to build on that bipartisan foundation by encouraging growth and job creation through our Tax Code. And I hope colleagues on both sides of the aisle agree. I am ready to get to work.

With that, let me turn it over to Senator Sessions for his opening remarks.

**OPENING STATEMENT OF SENATOR SESSIONS**

Senator SESSIONS. Thank you very much, Madam Chairman, and thank you, Secretary Lew, for being with us. You are a key player in this administration's financial and economic policy.

Let me give a brief perspective from my view. In 2009, the administration wagered America's financial future on the idea that a record increase in Government spending, funded by borrowing—debt—would revive the economy. Nobel Laureate Gary Becker wrote an editorial at that time that said it would not work. It was not sufficiently stimulative in the long run, and he was correct. It has not worked.

Growth is critical to America's progress. We all understand that. We know that is the big issue. And it is not an academic matter. Growth is not. It is real for workers in America. Will their wages go up? Will they have a better chance for having a job for themselves, their spouse, their children or grandchildren, or a lack of jobs because of a lack of growth?

CBO said that the stimulus bill would have a temporary boost, for the economy, but over 10 years we would have less growth than if we had had no stimulus bill at all. And that is where we are today. The growth is gone, and we are now slipping into the drag.

Since then, our Government debt has increased 64 percent and is on track to double by the end of the President's second term.

Now, what are the results? America is in the midst of the slowest recovery since the end of World War II. Workforce participation has shrunk to a nearly 40-year low. The Labor Department reports that most occupations pay less today than they did when the President took office. There has been a slide for over a decade, really, but it has accelerated in recent years.

Government debt has leaped from roughly $10 trillion to $17 trillion, yet with investors in the market doing well, median income has dropped $2,268 per household over the same time, and the decline has accelerated.

So this is a huge disaster. This is really bad. Working Americans are having their wages decline and unemployment remain exceedingly high, and two-thirds of the jobs last year that were created were part-time.

The justification for this unprecedented accumulation of debt was the claim it would lead to prosperity, and yet we have none of the prosperity and all of the debt. The plan has proven to be one of the most costly, failed gambits in American history. The White House's average growth projections for 2013—in their through 2009 through 2012 budgets was 3.9%. You were participating in that, Mr. Lew. You projected an average of 3.9 percent growth, and 2013 came in at 1.9 percent growth, a half of that. And that is a huge difference with real impact on millions of Americans.

So what does the President propose now in his new budget? Well, the plan increases spending growth again by almost $1 trillion, over $800 billion, bursting through the Ryan-Murray spending caps that he signed into law just 2 months ago. So while the military gets hammered, other agency budgets are soaring. We are surprised to see these numbers, Mr. Secretary. The budget proposes the following increases next year: a 45-percent increase for the Department of Housing and Urban Development; an 18-percent increase for the Legal Services Corporation; a 15-percent increase for the Department of Energy; a 30-percent increase for the Commodity Futures Trading Commission; and a 7-percent increase for the Bureau of Consumer Financial Protection.

So what is your cut in spending? I do not see it, frankly. But what we do see is a claim that we need to eliminate loopholes and that loopholes are spending. And we can cut spending by closing loopholes, and this is through the looking glass because closing loopholes, as we all know, is an increase in taxes. That is not a cut in spending. That is an increase in taxes.

So the plan raises taxes by more than $1 trillion in addition to the $1.7 trillion taxes that have already been raised during this administration's term. The new taxes include: limit the value of itemized deductions to raise taxes by $600 billion; raise the death tax by over $100 billion, after we agreed on the death tax numbers not long ago; increase taxes on unemployment insurance, $78 billion; increase taxes on energy production, $49 billion.

So the President raises taxes to increase spending. It is a tax-and-spend budget. It just is. It is not going to pass. It will never pass. So all together the White House budget plan would add another, by your own numbers, $8 trillion to the $17 trillion debt we have today.

So I think we need to focus on the seriousness of this situation, and I believe it is demonstrated most clearly by this fact: Last year, we paid our creditors $221 billion in interest on our Federal debt. That is a lot of money. The Federal highway bill is $40 billion or so. The aid to education is a little under $100 billion. We spent $221 billion first, the first thing we had to pay last year, in interest on our debt, and this is payments outside the Government to people who hold our debt, the public debt.

Under the President's plan, according to his own numbers, annual interest payments, though, will quadruple to $812 billion. Ten years from today, 1 year you calculate in your own numbers, Mr. Lew, that we would pay interest of $812 billion. CBO said it would be $880 billion in 10 years from today. I think their number is closer to correct. And rising interest payments represent, arguably, the greatest threat to our Nation's financial security.

Should interest rates increase even slightly over these projections, the cost of financing our debt would quickly surge to emergency levels. As Director Elmendorf told us, we face the risk of a fiscal crisis.

Clearly we must pursue a new course that creates jobs and does not add to the debt. That is what we have got to look to consider work on. And there are some ideas that are plainly there, and I have said before—I just listed them—that will work to create growth without debt. I will not repeat them today.

The Chair mentions the earned income tax credit. I think there is some possibility that we could make some progress and utilize that more effectively to fight poverty. I think it should absolutely be considered, but it cannot be just another social assistance program on top of the programs we have today. And we will have to ask how we can pay for it. We will have to consider carefully the impact that it will have on our budget.

So I guess I would just conclude to say you increase taxes and you increase spending. When you talk about a balanced budget, I asked a group of people from my cities today, when we had—when you hear the phrase from Washington, "a balanced plan to deal with our Nation's financial situation," do you think a balanced plan means there will be some raise in taxes and some cut in spending? And they said yes. But what we have here essentially from your plan is a tax situation where we raise taxes and raise spending. That is the wrong direction for America at this critical time.

I look forward to further discussions. Thank you, Madam Chair.

Chairman MURRAY. Thank you very much.

Secretary Lew, your testimony.

## STATEMENT OF THE HONORABLE JACOB J. LEW, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary Lew. Thank you, Chairman Murray, Ranking Member Sessions, members of the Committee. I appreciate this opportunity to testify today on the President's budget.

Before I begin, if I might, I would like to say a few words about Ukraine. Today the President will meet with the Ukrainian Prime Minister at the White House, and we are ready to do what we can to help Ukraine during this fragile period. Our ultimate goal, of course, is to work with all parties to de-escalate the situation in Ukraine, and we call on Russia to take the necessary actions to resolve this crisis.

It is in all of our interests to have a stable and prosperous Ukraine, and as the Ukrainian Government prepares for elections in May, it is critical that the international community support the government's efforts to restore economic stability.

We have been working closely with Congress to develop an assistance package that will help the Ukrainian Government meet some of its most pressing economic needs and lock in the fundamental reforms that will provide financial stability and put Ukraine on a path to long-term economic growth. This package includes a $1 billion loan guarantee, and we are ready to work with the Ukrainian Government to adopt the necessary reforms in conjunction with that assistance.

Our loan guarantee will supplement the core financial backstop from the IMF, and we are already engaging with our colleagues at the State Department and USAID to lay the groundwork.

As important as our assistance is, the IMF is the world's first responder in a crisis of this kind. That is why we are encouraged by the work in the Senate to approve the 2010 IMF quota reforms so that the IMF can provide the necessary resources to Ukraine and the United States can maintain its leadership within the Fund.

While the United States will not increase our total financial commitment to the IMF by approving the 2010 reforms, it is important to note that for every dollar of support the United States provides to the IMF, other member countries provide $4 more. At a time when the United States is at the forefront of international calls for urging the Fund to play a central and active first responder role in Ukraine, it is imperative that we secure passage of IMF legislation now so the IMF can provide the most effective assistance to Ukraine in its vulnerable moment and we can preserve our influential voice in this indispensable institution.

I want to be clear that even as we deal with the unfolding events in Ukraine, we continue to focus on our central objective: expanding opportunity for all Americans. Over the past 5 years, we have accomplished a number of important things to make our country stronger and better positioned for the future. In fact, since 2009, the economy has steadily expanded. Our businesses have added 8.7 million jobs over the last 48 months. The housing market has improved, and rising housing prices are pulling millions of homeowners out from under water.

At the same time, household and business balance sheets continue to heal, exports are growing, and manufacturing is making solid gains. The truth is, as the President said in his State of the Union, we are more ready to meet the demands of the 21st century than any other country on Earth.

Nevertheless, our economy was thrown against the ropes by the worst recession in our lifetimes, and while we are back on our feet, we are not yet where we want to be. Everyone here understands that. The question is: What are we going to do about it?

The President's budget lays out a clear path to move us in the right direction. It not only fulfills the President's pledge to make this a year of action, it offers a framework for long-term prosperity and competitiveness. This budget addresses the critical issues we face as a Nation. It recognizes that while corporate profits have been hitting all-time high, middle-class wages have hit a plateau, with long-term unemployment an ongoing challenge.

It recognizes that while the stock market has been vibrant, saving for retirement and paying for college is little more than a dream for millions of families. It recognizes that while our national security threats are shifting and we are bringing the war in Afghanistan to a responsible end, soldiers, military families, and veterans are struggling to success in our economy. And it recognizes that while work is being done to put the final pieces of financial reform in place, reforms like the Volcker rule have made our financial system strong and an engine for economic growth once again.

The solutions in this budget flow from a frank assessment of the challenges. They are carefully designed to show the choices we can make to increase opportunity and bolster the middle class. For instance, a cornerstone of these proposals is to expand the earned income tax credit so it reaches more childless workers. We know this credit is one of the most effective tools for fighting poverty, and it is time to adjust it so it does an even better job of rewarding hard work. This tax cut, which would go to more than 13 million Americans, will be fully offset by ending tax loopholes that let high-income professionals avoid the income and payroll taxes other workers pay.

Another initiative that will make a difference for hardworking men and women is myRA. This retirement security program will be available later this year, and it will allow Americans to start building a nest egg that is simple, safe, and can never go down in value.

While this budget puts forward essential pro-growth initiatives, it also calls on Congress to reinforce our growth-enhancing strategies by passing measures like comprehensive immigration reform and trade promotion authority.

But even as it does those things, make no mistake. This budget is also serious about building on the success we have made together to restore fiscal responsibility.

The fact of the matter is the deficit as a share of GDP has fallen by more than half since the President took office, marking the most rapid decline in the deficit since the period of demobilization following the end of World War II. The deficit is projected to narrow even more this year, and today we are charting a course that will push the deficit down to below 2 percent of GDP by 2024 and rein in the national debt relative to the size of the economy over 10 years.

Last year, the President put forward his last offer to Speaker Boehner in his budget as part of a balanced compromise. This year's budget reflects the President's vision of the best path forward. While the President stands by his last offer, he believes that the measures in his budget are the best ways to strengthen the economy now.

As this budget demonstrates, the President is firmly committed to making tough choices to tackle our fiscal challenges, and our fair and balanced solutions represent a comprehensive approach to strengthening our Nation's financial footing. This approach shrinks the deficit and debt by making detailed, responsible changes to Medicare, while eliminating wasteful corporate tax loopholes and subsidies that do not help our economy and scrapping tax breaks for those who do not need them.

Increasing basic fairness in our Tax Code is not just about improving our Nation's fiscal health, though. It is about generating room so we can make investments that will strengthen the foundation of our economy for years to come. That means helping to create more jobs by repairing our infrastructure, increasing manufacturing, boosting research and technology, and fostering domestic energy production. It means training Americans so they can get those jobs by promoting apprenticeships and upgrading worker training programs. It means improving our education system by expanding access to preschool and modernizing high schools. And it means making sure that hard work pays off by creating more Promise Zones, increasing college affordability, and raising the minimum wage to $10.10 an hour and indexing it to inflation.

In closing, let me point out this budget represents a powerful jobs, growth, and opportunity plan. It is carefully designed to make our economy stronger while keeping our fiscal house in order. What is more, it offers Washington a real chance to work together.

As everyone on this Committee knows, for far too long, brinksmanship in Washington has been a drag on economic growth. But thanks in large part to the work that you, Madam Chairman, have done, we have seen significant progress in making bipartisan progress in recent months, and that has helped to improve economic momentum.

Some cynics say it is fleeting. Some call it "election year posturing." But I do not agree. I believe this progress is real. I believe we can keep finding common ground to make a difference. And I believe we can continue to get serious things done on behalf of the American people by working together.

I thank you and look forward to answering your questions.

[The prepared statement of Secretary Lew follows:]

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**WRITTEN TESTIMONY OF SECRETARY JACOB J. LEW BEFORE THE SENATE BUDGET COMMITTEE ON THE PRESIDENT'S BUDGET FOR FISCAL YEAR 2015**
**MARCH 12, 2014**

Chairman Murray, Ranking Member Sessions, and Members of the Committee, thank you for the opportunity to appear before you today to discuss the President's Fiscal Year 2015 Budget.

The President's Budget invests in the United States economy to promote economic growth in the short-term and to strengthen the foundations for sustained prosperity in the long-term. The Budget builds on recent bipartisan achievements to make fiscal consolidation more balanced and incorporates initiatives to foster innovation, rebuild infrastructure, promote national security, and ensure economic, health, and retirement security for all Americans.

**Introduction**

When the President took office five years ago, the fiscal outlook for the federal government was bleak. The fiscal deficit was large—at nearly 10 percent of GDP—before any of his policies were enacted. Moreover, the economy was in the throes of the worst recession the nation had seen in generations. Since that time, both the sustained economic recovery and the policies put in place have resulted in a sharp decline in the deficit, putting us on a sustainable fiscal path.

From fiscal year 2009 to 2013, the deficit as a share of GDP fell by more than half to 4.1 percent. This 5.7 percentage point decline in the deficit is rapid by historical standards—over the past several decades, only the period of demobilization following the end of WWII has seen a faster pace of fiscal consolidation. For fiscal year 2014, the projection is for another reduction in the deficit, to 3.7 percent of GDP. A growing economy and our policy choices have dramatically improved our fiscal trajectory. Unfortunately some of the deficit reduction, particularly arbitrary spending cuts imposed by the sequester, have been a notable drag on the economy. More generally, the contentious political environment in Washington, governing from crisis to crisis, has held back the recovery that would have otherwise created more jobs for working Americans. Over the past couple of months, we have seen real progress in returning to regular order in conducting fiscal policy, and so I am hopeful that the bipartisan progress we have seen can continue. But such progress necessarily takes compromise to stimulate growth and curb the deficit. The President's FY 2015 Budget continues this trend. Under the FY 2015 Budget, the deficit will decline to less than 2 percent of GDP by 2024. Debt held by the public as a share of the economy will stabilize in FY 2015 and decline steadily thereafter until the end of the forecast horizon to 69 percent of GDP in 2024.

Over the past 4½ years, the United States economy has made clear and substantial progress recovering from the worst recession the nation has seen since the Great Depression. Although far more work remains to be done, the economy is poised to accelerate this year, continuing the recovery and putting millions more Americans back to work. While the economy has grown at an average rate of 2.3 percent since the recession, last year it grew 2.5 percent. Since February 2010, when the economy began producing jobs again, we have added 8.7 million new private-sector jobs, including 2.2 million over the past year. The housing market, which was the locus of

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much of the distress in the economy, is now rebounding, as rising house prices benefit millions of homeowners and activity in the sector shows signs of a building recovery.

Since the last time I testified on the President's budget, the economy has improved; but we cannot yet be satisfied with where we are. The unemployment rate has been around 6.7 percent since December, its lowest level since October 2008, but there are still millions of Americans in search of work as well as part-time workers in search of full-time opportunities. Moreover, the benefits of the growth we have seen are not being shared by all Americans. Median income for American families has been stagnant for years, while income at the very top has seen substantial growth.

Our recovery from the worst economic recession since the Great Depression continues to strengthen, but more needs to be done to accelerate growth and ensure the benefits of economic growth are not overly concentrated. The President's Budget presents a considered plan to build on the momentum of the recovering economy, to invest in long-term, sustainable growth for all Americans, but to remain dedicated to the need for fiscal responsibility. The recovery in the U.S. economy has helped to drive the world economy. At the G20 meetings, there was agreement that more needs to be done to stimulate growth around the world. With the building strength in our economy, we can maintain our leadership in the global community.

While the FY 2015 Budget adheres to the 2015 budget caps, it also includes a $56 billion Opportunity, Growth, and Security Initiative that will allow for additional discretionary investments to help expand economic growth and opportunity. This initiative follows the Bipartisan Budget Act (BBA) model of providing equal dollar sequestration relief for defense and non-defense outlays and is fully offset by a combination of revenue and non-health mandatory spending reforms. The initiative highlights the type of balance that the President has long been calling for by funding critical domestic initiatives. This Budget proposes to restore discretionary spending to a path that would support economic growth, opportunity, and security. In particular, while the BBA replaced half the discretionary sequestration cuts for 2014, it replaced just one-fifth of the scheduled cuts in discretionary funding for 2015. As a result, taking into account projected growth in programs such as veterans' medical care and other factors, the BBA non-defense discretionary funding levels for 2015 are several billion below the levels the Congress provided in 2014. They are also below 2007 funding levels adjusted for inflation, even though the need for pro-growth investments in infrastructure, education, and innovation has only increased due to the Great Recession and its aftermath.

The proposals in the President's Budget aim for balance to achieve long-run fiscal responsibility while promoting economic recovery and growth by eliminating waste, investing in the future, and reforming certain mandatory programs. The Budget calls for business tax reform that will make our companies more competitive but that will be revenue neutral in the long run. It introduces a plan to repair our existing infrastructure and expand it to support our economy for the next generation. The Budget increases the resources we are putting toward national security both at home and abroad because economic prosperity and fiscal responsibility cannot come at the expense of our safety. The Budget also proposes initiatives to improve early childhood education and skills training because investing in our nation's human capital will provide the best long-run return for the economy.

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Taking appropriate steps today will make our fiscal challenges easier tomorrow. A stronger economy today will ease those fiscal challenges and improve the lives of working Americans. A credible plan, built on the recent bipartisan cooperation that we have witnessed, is the best way to secure long-run growth.

**Investing in Jobs and Opportunity**

The strength of our country remains our ability to innovate, the greatest workers in the world, and our strong businesses. The United States competes in a global economy, and to continue to provide jobs and opportunity for Americans, we need to invest in American innovation, strengthen our manufacturing base, and keep our nation at the forefront of technology.

The President has called for the creation of a national network of manufacturing innovation institutes across the country. This network will bring together the private sector, universities, and the government to cooperate to develop world-leading technologies that will support domestic manufacturing. In 2011, the President launched SelectUSA, creating the first Federal effort to attract foreign business investment in the United States, and the Budget expands that effort.

The Budget calls for investing in a wide array of research and development (R&D), from advanced manufacturing and clean energy technology, to health care and agriculture. To support private-sector applied R&D, the Budget reforms and makes permanent the Research and Experimentation tax credit.

In order to secure America's energy future and to protect the planet for future generations, the Budget helps increase American low-carbon energy production while improving energy efficiency. Over the President's first term, the United States cut oil imports by more than 3.6 million barrels per day. To accelerate the progress toward energy independence, the Budget establishes an Energy Security Trust to help fund efforts to shift cars and trucks away from oil. The budget also combats climate change. It does this by investing in clean energy technology, promoting cleaner fossil fuels, supporting the development of carbon pollution standard for power plants and efficiency standards for appliances and buildings, expanding the Better Buildings Challenge and, encouraging international efforts to reduce greenhouse gas pollution.

**Building a 21st Century Infrastructure**

Long-term economic success depends on the infrastructure that supports our economy. That is why the Budget includes a proposal that uses one-time transition revenue resulting from business tax reform to fund a four-year, $300 billion surface transportation initiative that will improve our roads, bridges, and railways and will also create jobs across the country. And because funding is one of the most significant obstacles to getting infrastructure initiatives started, the Budget offers innovative ways to finance them. It continues to call for an independent National Infrastructure Bank with the ability to bring together private and public capital in support of a broad range of infrastructure projects, including transportation, energy, and water. At the same time, the Budget creates an America Fast Forward Bonds program to attract new sources of capital for

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infrastructure investment. Finally, the President has called for streamlining and accelerating the permitting process for infrastructure initiatives, and the Budget includes funding for a new Interagency Infrastructure Permitting Improvement Center to help with these efforts.

**Supporting Education and Providing Skills**

The single greatest resource that our economy has is our people, and it is critical that Americans have the skills and knowledge to compete in the global economy. Research has shown that investing in early childhood education pays great dividends for years to come. The Budget includes the Preschool for All initiative, which was first proposed by the President last year. This initiative involves partnering with States so that all low- and moderate-income four year olds have access to high-quality preschool and creating incentives for the States to expand these programs to reach additional children from middle-class families and establish full-day kindergarten policies. The Budget also provides $150 million for a new program to redesign high schools so students get relevant educations that meet the demands of current and future employers.

As important as it is for us to modernize and expand programs for young people, it is equally important that we modernize and expand job-training programs for current workers and job seekers. One way the Budget does this is by helping to increase registered apprenticeships, so that workers can "earn and learn" in cutting edge fields. Because long-term unemployment remains a pressing economic and social issue, the Budget provides resources for new public-private partnerships to help get the long-term unemployed back into paying jobs.

**Promoting Economic Opportunity and Mobility**

As I noted earlier, the economic recovery from the Great Recession has gained traction, but more work remains to be done, particularly to ensure that current and future opportunities are enjoyed by all Americans. Although the unemployment rate has fallen 3.4 percentage points since its peak in 2009, the long-term unemployment rate remains stubbornly high. At the end of last year, Emergency Unemployment Compensation for these Americans lapsed. Congress should renew this vital support for Americans in need, both because of the human suffering that it would reduce, but also because it would add strength to the economy. To increase opportunity for Americans, the Budget supports the Promise Zone initiative, which establishes partnerships with the Federal government, State governments, and businesses to create jobs, expand educational opportunities, and increase access to affordable housing.

In his State of the Union address earlier this year, the President called on Congress to raise the federal minimum wage to $10.10 per hour and to index it to inflation. No American who works full time should have to live in poverty, and the proposed new minimum wage would pull an estimated 1.6 million Americans out of poverty and add spending to the economy. The Earned Income Tax Credit (EITC) also provides support to low-income working Americans. The Budget expands the EITC available to workers without children and non-custodial parents, including by making the EITC more available to younger workers to encourage more young Americans to join the workforce at the critical beginning stages of their working lives. Improving the security of Americans in retirement is also an important policy goal. To that end,

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the Administration is moving forward with the myRA "starter" retirement account, and the Budget proposes to establish automatic enrollment IRAs to provide even broader access to retirement savings vehicles for Americans who do not currently have access to a workplace savings plan.

**Ensuring Our Nation's Safety and Security**

Sustained economic growth is only possible to achieve if our country is safe and secure, and the President's Budget bolsters national security both domestically and abroad. The Budget invests in the President's Now is the Time initiative to reduce gun violence, supports additional background checks for firearms dealers, and continues to support the Comprehensive School Safety Program and other programs that make our schools safer. Protecting our national security around the globe is equally important, and the Budget reflects a focused effort to address our highest defense priorities—bringing the war in Afghanistan to a responsible end, working to disrupt and disable terrorist networks, and assuring that our military is ready to respond to new threats such as cyber-attacks or attacks on the nation's critical infrastructure. Given the critical role our military plays, this budget provides significant resources to support veterans' medical care, help military families, assist soldiers transitioning to civilian life, reduce veterans' homelessness, and improve the disability claims processing system.

**Health Care Reform**

With continued implementation of the Affordable Care Act (ACA) and the opening of the Health Insurance Marketplace, millions of people have enrolled in either private insurance or received coverage through Medicaid and the Children's Health Insurance Program. The Budget fully funds the ongoing implementation of the ACA to make sure that coverage is affordable, to drive down long-term health care costs, and to improve the quality of health care for Americans.

At the same time, the President is committed to meaningful reforms to entitlement programs. The Budget includes $402 billion in savings on health care spending. The Budget includes proposals to increase care quality and efficiency and to reduce fraud in our Federal health care programs. The Budget also includes structural changes to Medicare that encourage beneficiaries to seek high-value healthcare services. The Budget proposes a reduction in the Federal subsidy of Medicare costs for those who need the subsidy the least. For new beneficiaries beginning in 2018, the Budget proposes a modified deductible for Medicare Part B and a modest copayment for some home health services. The Budget also has several proposals to contain the costs of medications, including encouraging the use of generic medications when clinically appropriate and closing the prescription drug coverage gap faster than current law. The Budget also seeks to align Medicare and Medicaid drug payment policies, addresses excess payments to hospitals and physicians, and increases access to generic drugs and biologics.

The Budget seeks to preserve the existing partnership between States and the Federal Government, while making Medicaid more efficient and sustainable. The Budget would limit Federal reimbursement for a State's Medicaid spending on certain durable medical equipment services to the equivalent Medicare payments in that State and includes targeted policies to lower drug costs in Medicaid. The Budget strengthens Medicaid and CHIP by providing tools to

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States, Territories, and the Federal Government to fight fraud, waste, and abuse, and make it easier for eligible children to get and maintain coverage. The Budget also includes other program improvements aimed at improving efficiency and effectiveness as States expand Medicaid.

Lastly, the Budget proposes a budget neutral pilot initiative under the Program for All-Inclusive Care for the Elderly (PACE) to test whether PACE programs can effectively serve a younger population without increasing costs. The Budget also supports a streamlined, single beneficiary appeals process for managed care plans that integrate Medicare and Medicaid payment and services. Finally, the Budget authorizes a permanent program to provide retroactive drug coverage for certain low-income Medicare beneficiaries through a single plan.

**Reforming the Tax Code**

The tax code should encourage public confidence and provide a simple level foundation for economic growth. However, over time, it has become unnecessarily complicated and a burden on the economy. Comprehensive tax reform holds the promise of improving economic growth by reducing complexity for individuals and small businesses, by curbing inefficient tax subsidies that distort individual and business decision-making, and by reducing the deficit. While the Administration's position is that tax reform should raise revenue, unfortunately, there is not agreement in Congress on whether tax reform should raise revenue or be revenue neutral. The President's Budget, however, builds on the bipartisan support for business tax reform. In February 2012, the President provided a framework for how business tax reform could be achieved. The Budget uses that framework to simplify and strengthen tax incentives for research and clean energy, to begin closing loopholes and eliminating special-interest subsidies, and to begin reforming the international tax system. The proposals would prevent U.S. companies from shifting profits overseas and prevent foreign companies in the U.S. from avoiding taxes that they owe. These proposals are part of a comprehensive—and long-run revenue neutral—business tax reform plan that would also cut the marginal tax rates for businesses.

As I noted above, the Budget also expands the earned income tax credit (EITC) for childless workers. The EITC has been a particularly effective tool at reducing poverty in this country, it has been supported by both parties, and creates crucial incentives to boost employment. The President proposes to strengthen the EITC, especially for young people that are just entering the labor force. Beyond these measures, the President is committed to working with the Congress to reform the tax code further to make it fairer, to promote economic growth and job creation, and to improve competitiveness.

**Comprehensive, Pro-growth Immigration Reform**

The President believes that we need to fix our broken immigration system by continuing to strengthen border security, by cracking down on employers who hire undocumented workers, by fixing our broken legal immigration system, and by providing a pathway to citizenship for hardworking men and women who are already here and contribute to our nation every day.

Immigration reform will encourage economic growth and help achieve better fiscal policy. The President has laid out principles for immigration reform but wants to work with Congress to craft

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specific legislation. But, the Congressional Budget Office estimates that the immigration bill that passed with bipartisan support in the Senate last year – and which is largely consistent with the President's vision – would reduce the deficit by about $160 billion in the first decade and by almost $850 billion over 20 years. Similarly, the Social Security Actuaries have found that the Senate bill would reduce the Social Security shortfall by $300 billion over the first 10 years. The Administration supports the Senate approach, and calls on the House of Representatives to act on comprehensive immigration reform this year.

**Conclusion**

In summary, the U.S. economy has made clear progress in the recovery from the Great Recession, but we cannot be satisfied with where we are. The labor market is clearly improving, but millions are still looking for work. This budget is a comprehensive and balanced approach to the realities we face. It supports the ongoing recovery and invests in long-term growth, while also building on the progress that has already been made to ensure a sustainable path for the debt and deficit.

The Budget is a credible, common sense plan that makes hard choices. It focuses on economic fundamentals that will help drive growth, create jobs, and expand opportunity for all Americans, unlocking a brighter future for future generations. I believe, as does the President, that the recent bipartisan cooperation on Capitol Hill demonstrates that we can find common ground to move our country forward. I look forward to working with Congress to get this done.

Chairman MURRAY. Thank you very much, Mr. Secretary.

Let me start with the fact that about 2 years ago the White House released a Framework for Business Tax Reform that lowered the top corporate rate to 28 percent on a revenue-neutral basis. That framework was updated last year, I think in a good way, to devote one-time revenues towards job-creating investments in our infrastructure.

I support asking some of the biggest beneficiaries of our infrastructure system to contribute to rebuilding that system in ways that will improve the productivity of business, both large and small, and relieve congestion for our workers. And I should add this is a fiscally responsible approach to corporate reform. We should not devote temporary revenues to permanent tax rate reductions.

The President's budget adopts this model. It devotes $150 billion in corporate revenue to the next surface transportation reauthorization and ensures the near-term solvency of our Highway Trust Fund that I mentioned in my opening remarks, a $60 billion shortfall. I wanted to ask you this morning if you can elaborate on the administration's—why they feel this is a strong approach and what your objectives area.

Secretary Lew. Senator Murray, I would love to. The President gave a speech in July where he laid the idea out, and the budget obviously carries that forward. And the idea is a simple one.

There is a convergence of thinking on business tax reform, and the outline that Congressman Camp put out, the administration's white paper, ideas that have been circulating in the Senate, they are not identical. But they are all moving in a similar direction.

And the proposition is a simple one. It says let us work on business tax reform and let us use the one-time revenues that come in in the initial 5, 10 years, and you really can only do two things with that if you are going to have a revenue-neutral bill: you either can reduce the deficit, or you can use it for one-time investments.

And we say put $150 billion into one-time investments, particularly in infrastructure, to get a jump-start on meeting the needs we have as a country to have a strong economic foundation for the future.

We actually think that there is a potential to work together here, and I say business tax reform because it is not just corporations. We have things in our white paper that actually would help businesses, whichever side of the Tax Code they are on. So it would give small business of any type the ability to deduct $1 million of expenditures in the first year that they make the expenditures, which is a huge benefit to small businesses as well as corporations.

So I hope that there is the basis for a conversation to go forward. It would make our country more competitive to have a lower statutory rate and fewer loopholes, and building our infrastructure— when I talk to CEOs around this country, the two things that they say we need to do is we need to make sure our infrastructure works and we train our young people to have the skills that they need. Those are the two things that they ask about.

Chairman MURRAY. I agree, and I do think there is room for us to start looking at how we can come together on that really critical issue. So I appreciate your addressing it.

Also, you mentioned in your opening remarks at the top the situation that is unfolding in Ukraine, which we all know is nothing short of a tragedy. Like everyone, my heart really goes out to those that continue to fight for a democratic Ukraine and for those who hope to see Crimea free from Russian forces.

The House, as you know, passed legislation providing $1 billion in loan guarantees last week to help stabilize the economy in Ukraine. I know that there are a number of our colleagues here in the Senate who are working on a larger package of reforms as well to respond to that, including legislation that would increase the amount of resources available to the International Monetary Fund. You mentioned this in your opening remarks as well.

But I wanted to ask you this morning while you are here if you can tell us why it is important for Congress to act quickly to pass comprehensive legislation that includes both financial assistance to the nation of Ukraine and language fulfilling the United States' commitment to increase the resources available to IMF.

Secretary Lew. Senator, I think if you look at what Ukraine needs, they need many things. They need to have a foundation to rebuild their economy. It is going to have to come from the IMF. It is going to be a package that could be as large as $15-plus billion. There is no one country, certainly not the United States, that could provide that level of support. That is why the IMF is so important. It is the first responder. It is the foundation. We as the leading voice, the only one with a veto power in the IMF, have an ability to help drive the IMF to do what it needs to do in situations like this. Approving the reforms strengths our voice. Not approving them weakens our voice.

We are already hearing calls by some to say if the United States does not approve its reforms, we should maybe move on without them. That is not a good place for the United States to be.

Specifically with regard to the Ukraine, Ukraine increases the amount that it can draw from the IMF in terms of flexible funds, from $1 billion to $1.6 billion when the reforms were approved. So it is, in general, important for us to be able to have the powerful voice that we have in the IMF, and it is specifically important to Ukraine in terms of how much they have access to.

Chairman MURRAY. Okay. Thank you very much. I think that is extremely important for us to understand here, so I appreciate it.

Senator Sessions?

Senator SESSIONS. Director Lew, with regard to Ukraine, I do believe that we need to assist, and I would look forward to working with you and the administration to achieve the kind of loan guarantee that has been discussed. It needs to be paid for, and it cannot be paid for by borrowing more or taxing more, in my view. There are plenty of monies that we can find for it.

Secondly, I think the plan, if it is tied to IMF reform, will create a lot of complications. I think you would be better off at this point not asking for that, because that has been on the agenda for a number of years. The administration has pushed for it, and it has not happened, and I think it could jeopardize this agreement.

Director Lew, last week Budget Director—Secretary Lew, former Director Lew.

Secretary Lew. I am proud of having been OMB Director, so I do not consider it—

Senator SESSIONS. It is the most August position maybe in the Government. She was here and she acknowledged really that the President's budget does change the Ryan-Murray law that he signed recently, and it would even within this year spend—even next year's budget of 2015, would spend $56 billion more than was agreed to under that law. Is that your understanding?

Secretary Lew. Senator, if I may just respond on the IMF, we think that without the IMF being the foundation, we will not be able to provide the level of support we need for Ukraine. So we view them as integrally connected, and we look forward to having conversations—

Senator SESSIONS. Well, there is some uncertainty from my perspective, and we will be glad to look at it.

Secretary Lew. Yes, and appreciate the importance of paying for it and are working to do that.

Chairman MURRAY. Before you respond, Senator Sessions, the votes have been called. There is a series of them. I am going to go vote right now. When you are done with your questions, I am going to turn to Senator King. I will try and be back as quickly as I can. We will just have to rotate. But if you want to continue. Thank you.

Senator SESSIONS. [Presiding.] Thank you. It is unfortunate. I wish we could have started a little earlier. Maybe we could have had less interruptions.

Secretary Lew. With regard to your question, you asked about the investments in our budget. We very much appreciate the importance of the budget agreement reached. We supported it. We built a budget that was based on it. And we said, as we have said before, that it is important to—as was outlined in the Budget Control Act—look for alternatives to the across-the-board cuts and the level of discretionary cuts that came out of that by putting other policies on the table so that we could still invest in the things we need for our country.

So we have a budget that has an investment fund that is paid for. We may not agree on how to pay for it, and obviously if we cannot agree on it, then the caps cannot be raised.

Senator SESSIONS. Well—thank you.

Secretary Lew. But we think it is consistent.

Senator SESSIONS. Well, I am not going to repeatedly argue with you about this, as I felt I needed to do with Director Burwell. It is not a question of being paid for. We agreed how much money we would spend next year, 2015. That was the agreement. And you want to spend more than that. If you want to raise taxes, then we ought to stay at that spending level and use the taxes to pay down the debt, reduce the deficit. That is the difference we have. And, fundamentally, we have a big question here, and you know it. I think the American people need to understand it more clearly. What do you do about our financial condition? What do we do about the budget? What is the way to have prosperity? Is it to raise taxes, to increase all these agencies' and departments' spending? Is it to extract more money from the private sector? Has that worked? Has it made life better for working Americans? I say not.

So this is—we have an honest disagreement. I am concerned about working Americans. I do not think they are doing well. I do not think the plan has worked. I did not believe it would from the beginning. Dr. Becker said it would not. I think he has been proven correct.

And one of the things that is really worrying me, having talked to the former Prime Minister of Canada, who produced five consecutive balanced budgets after being in a critical financial state, he said you have to focus on interest payments. That is the danger to the economy. That is what they did in Canada. They talked about it.

Isn't it true that our interest payment last year was $221 billion and, according to your estimates, it would move $812 billion in one year 10 years from today?

Secretary Lew. Senator, I do not disagree that we were on a better path when we were paying down the debt in the 1990s. It is a long time since then. We had decisions made that built up the deficit: a tax cut that was not paid for, wars that were not paid for, we had the worst financial crisis since the Great Depression. And we are now on a path towards digging our way out. We have cut the deficit in half. We are on a path to bringing the deficit to less than 2 percent of GDP. And we look forward to working together to make more progress, but we have to simultaneously invest in making sure we have the foundation for economic growth in the future.

Senator SESSIONS. Well, you have to watch it. What the Prime Minister of Canada, the Liberal Party Prime Minister, told us, told me yesterday was they cut spending and people—and a lot of spending, and they worked their way through it. And the people of Canada felt good when they saw the deficits falling rapidly and felt really good when they had a surplus. You have not led; the President has not led. All we have heard is we want to invest more at a time when deficits are huge and the interest rate is a stunning challenge for us.

The cost of the legislative branch, all of Congress, is $5 billion. From 2016, interest on the debt is one year will increase $66 billion. The judicial branch, including—and Department of Justice and the prisons is $38 billion. Interest rate would increase in one year $66 billion. The Department of Homeland Security budget is $49 billion. Interest would increase $66 billion just 3 years from now. It will average over $60 billion increases in interest payments per year. If interest were to surge higher than—not just returning to the mean, but went above the mean, wouldn't that place us in fiscal danger? And shouldn't we take action, like Canada did, now before it is too late?

Secretary Lew. Senator, I think the interest rate assumptions in the budget are prudent assumptions. They build in a path that has interest rates returning to normal levels in the period—

Senator SESSIONS. Well, that is what we hope, and CBO is close to the same numbers you are using. But we do not know. You predicted last year we would have almost twice the economic growth that we had. That was a huge miss. What if you miss on interest rates?

Secretary Lew. We could be over on some things and under on other things. There are a lot of moving pieces in economic projections. Obviously we try to get it right on everything, but I think that it is a prudent set of economic assumptions. It is a proper foundation for building a budget, and we revisit it every year, as every administration does.

Senator SESSIONS. Well, I think we are in the red zone, we are in the danger zone. We need to get out of it. If we have an international crisis of some kind that we do not predict or other things might happen we cannot foresee at this point, this Nation could find itself at great risk. And I believe you are pushing the envelope far too far.

I believe the Senator from Maine would be next.

Senator KING. Thank you, Senator Sessions.

I want to follow up and echo Senator Sessions' concerns. I think interest rates are a ticking time bomb, and if they return to 5 or 6 percent, which is where they were at the year 2000, we would be paying over $1 trillion a year in interest, and it would squeeze out everything. No matter what our priorities are around this table, it would squeeze them out, whether it is Pell grants, student loans, national parks, defense, air defense, whatever. And I believe we have to have a plan to start not to reduce the deficit, because you are reducing the deficit, you are still adding to the debt. And we need to think about reducing the debt itself, and certainly reducing the deficit.

So I believe that when we talk about tax reform and tax expenditures and reducing tax expenditures, we need to talk about interest rates, because $1 trillion a year of interest would just squeeze out everything else. So I think this is not something we can whistle by.

First, I want to thank you, Mr. Secretary, for the work that I know you have done on the Affordable Care Act regulations. I hope you will keep at that, keep after that, make them as simple, clean, streamlined, unburdensome as possible. I think it is very important for American business and for the success of the Affordable Care Act. I know you have been working hard on that, and I just want to say I appreciate that.

One of the issues is, the long-term large issue is: What is the right percentage of GDP for revenues? And it is argued that it should be the historic level of 17.5 to 18 percent. I would like to ask you—and you can take this for the record—to provide us with some data on the cost of the demographics in terms of GDP. In other words, it seems to me that saying it should be at the 40-year average does not make sense because of the demographic baby-boom retirement phenomenon that we have headed toward us. And is that 1 percent, 2 percent, 2.5 percent? That, it seems to me, gives us a better database to decide what the right percentage of GDP is for taxation. Is that something you could talk about?

Secretary Lew. Senator, I am happy to talk about it and happy to provide more in response for you after.

I think that, you know, there is no secret that with the baby boom approaching retirement, the demographics are changing, and the number of people eligible for Social Security and Medicare are growing. I mean, that was predictable 60 years ago, just as it is predictable today. We were building up reserves to pay for it. That was one of the notions of the 1983 Social Security reforms. As we ran a surplus in the 1990s, we were reloading the fiscal cannon to improve our fiscal health.

A lot of things happened between 2001 and now that caused the deficit to grow. So I think we have to separate what is our fiscal condition because of non-demographic factors and then what is the proper way to plan.

I think that, you know, there is no doubt that between 2001 and 2008 there were a lot of policy decisions that were made to take the surplus and reduce it. There were tax cuts enacted that were not paid for. We for the first time I think in our history fought two wars and did not pay for them in real time.

Senator KING. I do not disagree. We can—absolutely, there is plenty of fault to go around.

Secretary Lew. I actually was not doing it to ascribe fault. That is why we are now dealing with the demographic issue on top of the fiscal issue. I am just trying to separate them.

And we have funded the Social Security Trust Fund to deal with the retirement of the baby boom over the next several decades, and I think the problem is largely on the other side of the budget, that we have not run our fiscal policy so that we can keep those commitments. And I think it is a mistake to look just at the demographics, and we have to ask: What do we do to have a balanced approach to putting our fiscal house in order? And as part of that, we for a long time said balanced entitlement reform and tax reform have to go together, but they both have to contribute to deficit reduction. And that is kind of where they start to come together.

We have in this budget $400 billion of savings in Medicare. That is actually more savings than the 10-year window that the Bowles-Simpson Commission had in the same time frame. So it is not actually—we have not at all ignored the issue. There is still more that would require a different political context to deal with it. There has to be a willingness to move on multiple fronts in a balanced and fair way.

Senator KING. I agree. Changing the subject, we managed to raise the debt ceiling this year with a minimum of drama, but there has been—it has been rather dramatic in the past. I understand some years ago there was something applicable called the "Gephardt rule" that said when you increase spending, you automatically increase the debt ceiling. I think that makes a lot of sense. To me, it is too easy for us sitting around here to vote for spending and then later vote against the debt ceiling when the debt ceiling increase is implicit in the spending we just voted for.

What would you think about trying to reimpose something like the Gephardt rule so a budget resolution contained within it a debt ceiling?

Secretary Lew. Senator, I could not agree more that bringing together the decisions on fiscal policy, what we tax, what we spend, and how many commitments we make ought to be more integrally connected to our borrowing authority, because once we have made the commitments, it is really more of a ministerial act to raise the debt limit. We cannot not pay our bills.

You know, in full disclosure, I worked for the Speaker of the House when the Gephardt rule was put into place. I thought it was a good thing at the time because it made it less of a political hurdle and tied substantively the issues together where they belonged.

There are a lot of ways to make it easier to do the debt limit. We are one of very few countries that separates the policy decisions of how much to spend from the borrowing authority issue. And I think the closer together they are, the better. And I would be happy to work with you and others on exploring ideas.

Senator KING. I am working on a legislative version of the Gephardt rule and would be delighted to consult to have your expertise and what I now know is your historic knowledge. Thank you, Mr. Secretary.

Thank you, Madam Chairman.

Chairman MURRAY. [Presiding.] All right. Thank you very much.

Secretary Lew, we have a number of Senators who are returning to ask questions, and I will go ahead and ask a few while they do.

Secretary Lew. Sure.

Chairman MURRAY. And then I will yield to them as soon as one of them returns.

As you know, the earned income tax credit is really critical to providing economic opportunity for our low-income working families. As I said earlier, it lifts millions of families and children out of poverty every year by rewarding work. You have to earn wages to get the benefit of the EITC. That I think is something that appeals to both Democrats and Republicans.

The benefits to society are intergenerational. Studies have shown that kids in families who get the EITC go on to have higher educational outcomes, work more hours, earn more income.

But as effective as it is at encouraging work and reducing poverty and improving outcomes for kids, the credit is leaving low-income workers without dependent children behind, and I wanted you to comment on this idea that we have been talking about in terms of the EITC leaving behind a critical segment of our economy.

Secretary Lew. Yes, Senator, our budget proposes to fix that by making single childless workers eligible and increasing the amount for which they would be eligible. I think it is extremely important. You know, we are talking about low-income working people who are struggling to get started, who where the incentive to work should be strong, where early attachment to the workforce in some cases can be part of a career-shaping life experience.

You look at the history of the earned income tax credit, it has been a history of bipartisanship. It was started in the Nixon-Ford years, and in almost every administration, Republican or Democrat, it has been expanded because there has been a consensus that encouraging work, making work pay, is something we actually all can agree on.

I hope that the proposal that we put forward is the basis for that kind of a conversation and that, you know, young workers, single workers who are low-income workers, are able to get the benefit of the earned income tax credit and the incentive to be part of the workforce and stay in the workforce.

Chairman MURRAY. Good. Well, I look forward to having that conversation with you and with everyone as we move forward.

Senator Whitehouse?

Senator WHITEHOUSE. Thank you, Chairman. Welcome, Mr. Secretary.

I do this virtually every time, but I really have to point out yet again that our friends on the other side talk a good game on the deficit, but whenever it is crunch time, they will stick up for the carried interest exemption for billionaires instead of deficit reduction; they will stick up for corporate offshoring of revenues and hiding from the tax guy offshore instead of dealing with the deficit; they will protect oil subsidies rather than deal with the deficit. So don't just look at their words when you hear this. Look at their actions, because over and over again they have showed that the special interest loopholes are preferred to dealing with the deficit. And, indeed, you heard the Ranking Member say today that closing loopholes is just a way of increasing taxes, and I guess they want to continue to defend this stuff. I do not see how that is defensible, and we are going to continue to have that conversation.

Your testimony says that the administration's position is that tax reform should raise revenue, and yet you recommend corporation tax reform that is revenue neutral. Could you explain why you are not doing what you say you should with corporate tax reform?

Secretary Lew. Well, Senator, we have said overall comprehensive tax reform should be part of the solution. On the business side, we are very concerned that the high statutory tax rate in the United States is a real problem in terms of our competitiveness, in terms of our ability to retain and attract corporate headquarters and job creators in the United States. And we think the way to resolve that is to eliminate loopholes in the business Tax Code and to lower the statutory rate.

There has been a lot of debate about how low the statutory rate can be. We have not been able to come up with a plan that would get it below 28 percent without using the revenue from closing loopholes to lower the statutory rate. So it was really a pragmatic conclusion that we believe the statutory rate needs to come down and we need to pay for that. And on the individual side is where most of the revenue is. It is where the loopholes that are available for mostly very high income taxpayers are most profound. And in the process of comprehensive tax reform, we believe that it has to be part of an overall fiscal plan, which is why we think you can separate business tax reform and do it on its own.

Senator WHITEHOUSE. I know you are not there and I do not want to put you in the position of saying that you are there or are going to be there, but for the record, a carbon fee at the level of the previous social cost of carbon, if applied to corporate tax rates, could reduce it, I believe, all the way to 25 percent before you even get into loophole closing and, in addition, would rev up the green energy economy, which creates more jobs right now than oil and gas do anyway and would help us reduce the really terrible long-term liabilities associated with adapting to and mitigating the changes that climate change is going to cause us.

Is there a place where the United States Government tries to look forward to those liabilities and put them on the books someplace, the cost of coastal damage, the cost of—

Secretary Lew. It is actually an interesting question that you ask. In the context of our budget this year, we tried to look at how do you deal with the questions of resilience and building a capability to respond to the increasingly frequent kind of natural disasters that result from climate change. I think that is a conversation we need to have, and figuring out a way to pay for it is very important. The President suggested that we need to think about that.

I think that we are all in the relatively early stages of thinking that through, and it is something that we—

Senator WHITEHOUSE. Well, my time is running out, so let me just make one last point, which is that I would—I continue to urge the administration on health care to set a target for delivery system savings. You know that health care expense is probably the number one part of our budget problem. Health care expense is largely the result of health care cost. Health care cost in America is unjustifiably and uniquely high compared to the rest of the world. And there is a lot of effort that is being put into reducing that cost, and people are being given a direction by the administration, which is to bend the health care cost curve. But that is only a direction. That is not a goal. And being told which way to go versus how far to go are two very different things. And I think that the failure to produce an articulable goal for health care savings from delivery system reform is a really serious failing, and I urge you to keep looking at that.

Secretary Lew. Senator, we have over the years discussed this, and I compliment the work you have done in this area. I think that what we have done is we have made policy changes in the Affordable Care Act in particular that are having a real impact on bending the cost curve. We are seeing the slowest increase in health care costs in a long time.

I do not disagree with you that we need to get more progress in—

Senator WHITEHOUSE. I am over my time, so I do not want to get into a debate, but the good things that you have done make it all the more frustrating that there is still this gap.

Chairman MURRAY. Senator Toomey.

Senator TOOMEY. Thank you, Madam Chairman, and thank you, Mr. Secretary, for joining us.

I wanted to follow up on a concern raised by Senator Sessions about the IMF reforms. I understand the administration wants to get this done. I share his view. Frankly, I would like us to move forward on a well-crafted package of aid for Ukraine. I think that makes a lot of sense. I am concerned that this unnecessarily complicates it, so I want to make sure that I am clear about this.

It is my understanding that the reforms are not actually necessary for the IMF to proceed with the $15 billion loan package that is under consideration. And while that amount is far in excess of the normal limit that would apply for Ukraine's quota, the IMF has a framework in place for those kinds of circumstances, the Exceptional Access Framework. It has been used in the past. It could be used again.

So am I correct in understanding that it is not actually essential to complete that $15 billion package to have the reforms adopted by the United States?

Secretary Lew. Senator, there is a distinction between the flexible window, which would go from $1 billion to $1.6 billion, and the extraordinary package. And the extraordinary package is not governed by quota share.

What is very much the case is that our voice in the IMF is affected by whether or not we approve quota reform, and our ability to drive that package in the direction that we think it needs to go is diminished if we do not act on it.

Senator TOOMEY. Okay. Fair point.

Secretary LEW. And one point I should make is in terms of the complication, we are working very closely with the Government of Ukraine. I have talked to the Prime Minister a number of times. I will be meeting with him today and tomorrow. Ukraine has sufficient cash for the immediate future. Their need is not today or tomorrow. It is in Ukraine's interest that we get this right. And if we do the three-part package that is being developed in the Senate Foreign Relations Committee, that will be the best way to help Ukraine.

Senator TOOMEY. Okay. And I just—you confirmed—you would like to have it. I understand that. And you believe it enhances our ability to influence the composition of the package. I get that. But it is not actually—

Secretary LEW. Yes, Senator, I have conversations with my counterparts every day, Foreign Ministers from other countries.

Senator TOOMEY. Right.

Secretary LEW. I am in one part of the conversation urging them to do what we want, and in the other part of the conversation answering when are you finally going to do the quota reforms. We need to not be on the defense. We need to be the strongest country in the world.

Senator TOOMEY. Well, the other thing that is just a little peculiar about the reforms is, it seems to me, an unfortunate timing in some respects since this is in response to the outrageous behavior of the Russian Government to some degree, and yet the reforms actually diminish American voting power and increase Russia's voting power. So it sort of looks like it sends a bit of a mixed signal.

But I wanted to raise another issue, and that is the Government's role with Fannie and Freddie. As you know, when the Government stepped in and bailed out Fannie and Freddie, the Government signed a very specific agreement with the Board of Directors, which they entered into voluntarily. It involves the Government providing guarantees and a line of credit and a very specific return, that the Government would get a 10-percent return on money extended and options to purchase 79.9 percent of the equity.

In August of 2012, just as it was becoming apparent that Fannie and Freddie were going to return to significant profitability, the Government came along and negotiated a new deal with itself. With the Treasury Secretary on one side and a Government-appointed regulator on the other side, they wrote a new agreement whereby the Government now gets 100 percent of the profits when the previous agreement stipulated that they would have ownership of just under 80 percent.

Isn't this a serious breach of the sanctity of contracts? And doesn't this undermine our commitment to the rule of law to have done this?

Secretary Lew. Senator, you know, we have had a very clear policy on Fannie and Freddie, which is that we are winding them down, and that is why it is so important that we are making progress in a bipartisan basis to work on housing finance reform. I think that when you look at the agreements that were made for the Federal Government to step in and become a conservator and the subsequent agreements that were made, it serves the public interest, and the sooner we get on with the debate of housing finance reform, the better.

We have sent clear signals of what our policy intent was so no one was not warned of what the goal was. And, you know, I think the damage done to our economy because of the failures of Fannie and Freddie were deep, and I think that the policies in place are right.

If I could just respond, though, on the point you made about Russia, just a technical matter—

Senator TOOMEY. I would like a quick follow-up on the Fannie and Freddie question, but go ahead.

Secretary Lew. As just a factual matter, Russia's share goes up a trivial 0.2 percent, from 2.4 to 2.6. The important thing about the 2010 agreement is the United States maintains its veto authority and the reallocation of shares did not reduce the U.S. influence on the IMF, which is why it is so important that we get it done.

Senator TOOMEY. Well, I am happy to have that conversation. I just think it would be better to do it on a different vehicle.

And just a final word on Fannie and Freddie. Whatever policies have been signaled—and I am one that believes we absolutely cannot go back to the status quo ante. I think that was a very bad model that we had. I criticized it in the past. I certainly do not want to return to that. And, by the way, I will be the first to acknowledge that the taxpayers have not yet gotten the return on the money that they have extended. They have back an amount about equal to the principal amount, no return, no interest, none of the 10 percent. So—

Secretary Lew. Nothing close to the damage to the economy.

Senator TOOMEY. By no means has that occurred. But whatever signals you have sent about policy cannot be more important than a contract that has been signed. And when the American people—and that includes savers, investors, pension funds, community banks—all across the country cannot have confidence in a contract that they have with the United States Government, I think that has a chilling effect on our economy as well, and our ability to attract the private capital to reform Fannie and Freddie. So I am very concerned about that.

Thank you, Madam Chairman, for the indulgence.

Chairman MURRAY. Thank you very much.

As I said, we have a series of votes, so people are racing to the floor and back. I know we have several people who want to return. The second vote has just been called. I am going to go ahead and put us into recess.

Secretary Lew. Sure.

Chairman MURRAY. So we will hold temporarily until we get someone back here. I know Senator Portman wanted to return. We will make an assessment of how many people—

Secretary Lew. Senator, since once of those votes is to confirm my Deputy, I encourage the votes to go on.

[Laughter.]

Chairman MURRAY. Okay. We will work on that.

Secretary Lew. Thank you.

Chairman MURRAY. So a temporary recess, and we will return.

[Recess.]

Chairman MURRAY. We will bring this hearing back into session. We have one final questioner for Secretary Lew. Senator Graham?

Senator GRAHAM. I am last and least, so I appreciate it.

IMF—you are making an argument to the Congress that the reform package, the expansion of contribution, could really help our economic and national security interest. Is that the message you are delivering to us?

Secretary Lew. Yes, it is.

Senator GRAHAM. In terms of the Ukraine, it could have an exponential effect in terms of providing economic support to the Ukrainian people at the time they need it the most. Right?

Secretary Lew. Absolutely.

Senator GRAHAM. For a relatively small cost to the American taxpayer.

Secretary Lew. It is truly a technical cost.

Senator GRAHAM. It is not even a rounding error. So to those of us who believe the world is rapidly changing and we need to be influential, being a member of the IMF—and Ms. Lagarde is doing a terrific job, I think. Would you share that view of her?

Secretary Lew. Yes, I do.

Senator GRAHAM. It is a reformed organization, so the Congress has an opportunity here to increase the effect of an international organization to provide economic stability in troubled regions, and that is what you are urging us to do, is to seize the moment.

Secretary Lew. Indeed it is.

Senator GRAHAM. Okay. Thank you.

Now, as to our overall problems as a Nation, am I correct that by year 10 of sequestration, if nothing changes, we will be spending 2.3 percent of our GDP on defense?

Secretary Lew. I would have to look up the number. It sounds right.

Senator GRAHAM. Okay. Let me know if I am wrong. Sequestration, I think you have said in the past, was a very bad idea. Do you still concur with that?

Secretary Lew. Yes, it was designed to be so bad that nobody would let it happen—

Senator GRAHAM. Yes, so only we could do that, design something so bad that we would not let it happen.

Secretary Lew. Correct, and so we would do something sensible instead.

Senator GRAHAM. Right. Okay. So let us talk about how sensible we could possibly be. If you left $100 billion intact over the next 7 or 8 years, what is left of sequestration, on the defense and the non-defense side, how much would we have to replace? Around $400 billion, is that right?

Secretary Lew. If you left how much? I am sorry.

Senator GRAHAM. $100 billion on the defense side and the non-defense side.

Secretary Lew. Well, if it was $100 billion and $100 billion, you would have $200 billion if it was over 10 years. Obviously it depends on what the annual amount was.

Senator GRAHAM. But what I am saying is that we could leave some sequestration intact.

Secretary Lew. Sure, and that is consistent with the agreement that Senator Murray and Congressman Ryan reached.

Senator GRAHAM. Right.

Secretary Lew. Where they backed out a part of sequestration with a balanced package of savings.

Senator GRAHAM. Well, let us see if we can back out some more.

Secretary Lew. And that is what the President has proposed to do, to have an equal 50 percent of the increases that he would pay for would go to defense and half for non-defense.

Senator GRAHAM. Okay. So if we could figure out how much to leave on the table for sequestration that our defense community could absorb and the non-defense sector could absorb without doing structural damage, the deal would go something like this: We would have entitlement reform as part of the replacement. Do you agree with me if you did that, you would want to look at a 30-year window in terms of reduction in spending, not 10?

Secretary Lew. Well, I think for entitlements and revenues, looking at—

Senator GRAHAM. I am talking about doing both. I am talking about doing both.

Secretary Lew. I understand, but for both, looking outside the 10-year window makes sense because they tend to arc up over time.

Senator GRAHAM. Right. So if we looked at whatever we did to generate revenue over a 30-year period and whatever we did on entitlement reform over a 30-year period—

Secretary Lew. Yes.

Senator GRAHAM. —that would probably be a better indicator of how it would benefit the country.

Secretary Lew. With the obvious caveat that our estimates are weaker as we get into the out-years.

Senator GRAHAM. I agree. But the concept—

Secretary Lew. The concept, the direction—you certainly need to know the trajectory.

Senator GRAHAM. Okay. So is the President willing to sit down and try to accomplish that goal?

Secretary Lew. Senator, the President not only is willing, he has sat down and tried very hard—

Senator GRAHAM. I have sat down for weeks over there, and we could not get there.

Secretary Lew. We have not gotten there, and I think some Senators on your side, some representatives on your side are willing to think about a balanced package. But we have not gotten to the point where we have had a consensus.

Senator GRAHAM. Now, that is going to require structural reform to entitlements, right?

Secretary Lew. Yeah, I think that the President has made clear and by putting in his budget last year his last offer to Speaker Boehner he made clear that he was willing to do that. When that did not go anywhere—

Senator GRAHAM. Okay. I got—

Secretary Lew. —he just is starting the conversation with what he thinks is the best—

Senator GRAHAM. Ten thousand baby boomers a day retiring.

Secretary Lew. Yes.

Senator GRAHAM. Do you believe it is smart to eventually adjust the age for retirement for Social Security and Medicare and to means-test benefits as part of a balanced package?

Secretary Lew. Well, we have included in our budget the—

Senator GRAHAM. Some means testing.

Secretary Lew. —the means testing as—you know, the income-related premium—

Senator GRAHAM. Yeah, absolutely.

Secretary Lew. —as a form of means testing.

Secretary Lew. But to do more—

Secretary Lew. In terms of—

Senator GRAHAM. If we could do the revenue side.

Secretary Lew. In terms of adjusting the CPI, you know, our view is that it was never an easy thing to do, but—

Senator GRAHAM. What about adjusting the age for retirement?

Secretary Lew. See, I—

Senator GRAHAM. If I am willing to do revenue, would you be willing to do that?

Secretary Lew. I think what the President made clear in all of his negotiations that he is willing to put together a balanced package, doing hard things. I think it is probably not the right time for me to say which of the things that we would do, but I think his bona fides are clear. He showed he was willing to do it.

I think that this is probably not the 6-to 9-month window when we are likely to get that done.

Senator GRAHAM. I agree with that.

Secretary Lew. And we have a lot of other things we need to make progress on, so this is a budget that is really to do some of the other things we can do to build our economy. But we know this is a conversation—

Senator GRAHAM. Hopefully we will see you after the election.

Secretary Lew. And I just want to thank you, Senator, for the leadership you have shown on this IMF issue. It is just critically important that we increase Ukraine's access to an additional $600 million of flexible financing and that we restore and maintain our leadership in that critical institution. I thank you for your help.

Chairman MURRAY. Thank you very much. And, Secretary Lew, thank you for your flexibility, and to all of our colleagues today. We really appreciate the hard work that you and your staff put into all of this at the Department of Treasury.

As a reminder to my colleagues, additional statements or questions for Secretary Lew are due by 6:00 p.m. today.

With that, I will call this hearing to a close.

Secretary Lew. Thank you, Senator.

[Whereupon, at 11:36 a.m., the Committee was adjourned.]

# THE PRESIDENT'S FISCAL YEAR 2015 EDUCATION BUDGET REQUEST

**TUESDAY, MAY 6, 2014**

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
*Washington, D.C.*

The Committee met, pursuant to notice, at 10:32 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Whitehouse, Sessions, Grassley, Crapo, and Wicker.

Staff Present: Evan T. Schatz, Majority Staff Director; and Eric M. Ueland, Minority Staff Director.

## OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. Good morning. This hearing will come to order.

I want to welcome everyone and thank Ranking Member Sessions and all of our colleagues for joining us here today. And I especially want to thank Secretary Duncan for taking time to be here to detail the administration's vision for investing in a world-class education system.

A quality education opens up opportunities and can give people a shot at living out the American dream, and a strong education lays the groundwork for economic growth and prosperity for our future.

But right now, our Nation is facing an education deficit. College is becoming more and more unaffordable for American families; workforce training and adult education programs must do a better job of lining up our workforce with the skills needed to succeed in our economy; and many schools are struggling to get students ready for success in the classroom and in future careers.

In a recent assessment, U.S. students ranked below average in math compared to students in other developed countries, and our students ranked only average in science and reading. As we struggle to prepare our students, other countries are gaining a significant and potentially lasting advantage.

We also see gaps in achievement between African American and Latino students with their counterparts. While a quality education can be a pathway toward success, the inverse is also true. Failing to make important investments so that every child has access to a world-class education can weaken opportunities for Americans, and it hinders our Nation's ability to lead on the world stage. Where there is an education deficit, there is also an opportunity deficit. So one of the challenges for this Committee is to find ways to better invest in education.

The Murray-Ryan deal was a strong step in the right direction. For far too long, Congress had been lurching from one budget crisis to the next. But as you know, at the end of last year, Chairman Ryan and I finally sat down to negotiate in a budget conference. We put ideas on the table, we made some tough compromises, we put partisanship aside, and we reached a deal.

Our bipartisan 2-year budget rolled back some of the most damaging cuts from sequestration. It prevented a Government shutdown in January. And it will help avoid another one this October. And it set spending levels for fiscal years 2014 and 2015. Nobody thinks our 2-year budget deal was perfect. It was a compromise. And now we need to look at ways to build on that agreement by focusing on bipartisan areas of investment like education and workforce training.

The President's budget proposal would do just that by expanding education opportunities from early learning all the way to college and career training. I was pleased to see this budget continues the administration's commitment to expand early learning. As a former preschool teacher, I have seen firsthand how early learning can give kids a strong foundation, not just to start kindergarten ready to learn but to succeed later in life.

But it is not just educators who recognize the importance of early learning. I have heard from sheriffs in Washington State, business executives, and military leaders who all support early learning because of the long-term benefits it provides.

In Congress, Democrats have proposed a bill to expand early learning programs across the country. Early learning should not be a partisan issue, and I am hoping that Republicans will support that legislation to expand high-quality preschool programs.

We also need strong K–12 schools to make sure our kids can compete in a global economy. That starts with basic skills like reading and writing.

Several years ago, Senator Sessions and I worked on that national priority, and together we introduced a bill to boost literacy programs in schools around the country. In the President's budget proposal, I was glad to see it includes strong support for a program I have championed called the "Striving Reader's Comprehensive Literacy Program." Boosting literacy will help students get the skills they need to succeed in a 21st century economy.

Right now, K–12 schools are facing a very difficult situation in my home State of Washington. Secretary Duncan, as you well know, it is the first State to lose its waiver from some requirements mandated by No Child Left Behind. As you and I have now talked about several times, I am very disappointed by the loss of this waiver, and I am extremely concerned about the impact it is going to have on our students, our teachers, and our families.

Now it is critical for all of us at the State and Federal level to come together to rectify this situation and put our students first. At the Federal level, my focus will be on reauthorizing the Elementary and Secondary Education Act. It is long overdue, and it is time for Congress to work on that legislation and strengthen our K–12 schools.

The President's budget also includes proposals to support all students who want post-secondary education, and that includes job training. Expanding apprenticeship programs would help train workers in the skills that businesses need and would help those workers secure good middle-class jobs.

The proposal also include ability to benefit, which has been one of my priorities. Budget cutbacks in 2012 eliminated student aid for those who did not have a GED or high school diploma. But any student who wants to pursue higher education should have that chance, so I am glad the budget would restore job training opportunities for low-income students.

One in six adults in our country score below average in literacy and basic math skills, according to a study by the OECD. That is why I am a strong supporter of a program in Washington State called I–BEST that helps students gain basic skills like reading as well as skills for the workplace. We need more support at the Federal level for programs that strengthen our workforce.

I also look forward to hearing from the Secretary about higher education and college affordability. Specifically, I have very serious concerns about recent allegations that student loan servicers have been violating the law when it comes to how they are treating our men and women in uniform who are deployed abroad. I hope to hear today, Secretary Duncan, how you are handling this situation, ensuring that we keep our promises to our servicemembers.

More broadly, I believe getting a college degree should not be as cost-prohibitive to so many families as it is today. The average student today graduates from college with more than $29,000 in debt. So I hope to hear from the Secretary today about the ongoing discussion in Congress to give students the option to refinance their school loans as well as how we are going to maintain Pell grants that help low-and middle-income students get the chance to go to college.

But student debt and grants are not the only factors we need to talk about. The cost of college is too high, and it is only getting more expensive. That is prompting students to take out hefty loans that have serious impacts on their financial security after they graduate. I look forward to hearing today about how we are going to tackle both sides of the equation here—the rising cost of college in the first place and what that means for families and students who are being forced to take out more and more debt—because, unfortunately, in recent years States have reduced their investments in higher education. Forty-eight States now are spending less on higher education than they did before the recession hit in 2007. That is according to the Center on Budget and Policy Priorities.

We know that education is fundamental to expand opportunities to more Americans. That is why students at every stage of their learning, from preschool to college and career training, deserve a quality education. The President's education proposal is a strong plan to build on our 2-year budget deal. Now it is time for Congress to work together to make investments in a world-class education system. If we do that, we will lay the groundwork for economic prosperity. We will help students get the skills they need to lead in the 21st century, and we will give our kids a better shot at living out the American dream.

So, Secretary Duncan, thank you again for being here. I look forward to your testimony, and before I turn to you, I will turn to my counterpart, Senator Sessions, for his opening remarks.

**OPENING STATEMENT OF SENATOR SESSIONS**

Senator SESSIONS. Thank you, Madam Chairman. We appreciate your leadership and your expertise in matters of education.

Secretary Duncan, you came to this job with some real experience in it, having battled on a lot of important issues, and we appreciate your service. And I do think it is a little unfair, some of the rankings nationally, because does anybody doubt that China does not count a lot of the rural areas where education is weaker? We are more honest in the way we account for our progress in education, and I really respect our teachers. I know they work hard every day, and helping them do their job better is something we all should focus on.

I am proud of Alabama's education program. With very little new money, using their reading initiative and their math and science initiative that they developed based on scientifically proven methods to help children learn, they have achieved remarkable success. And, Mr. Secretary, thank you for examining that and looking at it at my request. Using good techniques can help education without a lot of new money.

Washington does not educate children. More money alone does not improve learning. Better results, I know you agree, must be the goal. So you must know, Mr. Secretary, that your Government is running out of money. Congress and the President agreed to certain spending limits in the Ryan-Murray legislation that I think did get us past a difficult time. But you simply are proposing now spending well above that with your Oppurtunity Growth and Security Initiative, some $56 billion above what we agreed to spend. You are violating the spending limits that we agreed to and the President signed into law. And so that is just not going to be possible. We just cannot and we will not, I believe, do that.

So if you and the administration want to spend more money on education, you must make it a priority within the discretionary accounts, reducing spending somewhere else. Simply proposing to break the spending limits is irresponsible. It is more of a political gesture and not a serious policy proposal. We must and will, I think, stick to the Ryan-Murray spending limits. The very future of our country and the quality of our children's future depends on wise management of our money today.

Overall, the President's budget would add about $8 trillion to our debt, our current $17 trillion debt. It would add $8 trillion to that over the next 10 years. According to the Congressional Budget Office, this massive debt accumulation means annual interest payments will nearly quadruple over the next decade. You get less than $60 billion a year, I guess, on your base budget, less than $70. Last year, we paid our creditors $221 billion in that year alone in interest on our debt. That is more than 6 times what we spend on Pell grants.

Accordingly, in 2024, 10 years from today, one single year's interest payment, according to CBO, will be $876 billion. Again, that is just one year's payment. The one-year debt interest payment in

2024 will be greater than the amount we will spend on your Education budget over the next 10 years total.

So interest has got to be paid. The huge demands that interest places on us will steal money from all accounts, including the Education account. So deficits matter. Debts have consequences. If you truly want to support our Nation's children, then we have got to live within the limits that we have set for ourselves.

At the same time, we must recognize that more money does not always produce better results. Some of the worst-performing schools in the country are some of the best-funded. Base education spending has increased 15 percent from 2008 through 2014 without a corresponding increase in education scores, and you propose another increase of $1.3 billion next year, not counting the initiative, the new Opportunity Growth and Security Initiative that I mentioned earlier.

So more Federal money is not a substitute for the support of family or community for the value of a role model or mentor or the quality of a great teacher. More money cannot make a student do his homework or show up on time for class. More money will not ensure that a teacher will use the best methods.

So we also owe our students a secure future when they graduate. We must work to ensure there are jobs waiting for them.

The Pell grant program and college loans that you supervise, those programs—well, Pell grants have received no reductions in the Budget Control Act or the sequester. But we have to ensure that they work well.

Nearly one in two recent college graduates are unemployed, but the administration proposes to double the number of guest workers to fill jobs throughout our economy, including a large increase in STEM guest workers where, it is said, a crucial shortage of workers exist. But contrary to the claims of various technology corporations, we actually appear to have a surplus of STEM-trained American students who are looking for work.

As Professor Hal Salzman of Rutgers recently wrote, "The Nation graduates more than 2 times as many STEM students each year as find jobs in STEM fields. For the 180,000 or so openings annually, colleges and universities supply 500,000 graduates." That is what he said. And I think other data tends to confirm that.

Meanwhile, many of those guest workers' visas were used to offshore American jobs, and it is not a healthy trend, and we have to examine, I believe, in utilizing our resources for higher education, ways to make sure that the positions we train people for are actually out there. So across the board, we must do more to ensure that American youth find good jobs.

But here is what I think we should fundamentally do to improve the opportunities for our graduates, and I guess the first one today we should talk about is we should reform education to make it better prepare students for jobs that exist at the lowest possible cost and try to implement the policies we know will help education help students to the maximum degree. And we have got to produce more American energy, eliminate costly and unnecessary regulations, make the Tax Code more growth oriented, turn the welfare office into a job training office to help people who are hurting today get jobs on a path to prosperity and streamline Government to make it better, and balance the Federal budget, which I believe our failure to do so is threatening growth today.

Thank you, Madam Chairman. I look forward to hearing from our guest.

Chairman MURRAY. Thank you very much.

Secretary Duncan, we will turn to you, and, again, thank you for being here today.

**STATEMENT OF THE HONORABLE ARNE DUNCAN, SECRETARY, U.S. DEPARTMENT OF EDUCATION; ACCOMPANIED BY THOMAS SKELLY, ACTING CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF EDUCATION**

Secretary Duncan. Thank you so much, Chairman Murray, Ranking Member Sessions, and other Senators.

Let me first begin by thanking you for your work on the 2014 budget, which increased our investment in education over the previous year. Your ability to overcome partisan disagreements in the interest of America's children has provided both stability and clarity that serve America's families and schools well. That investment is a vital part of the good news in America's educational good-news and bad-news story.

On the good-news side first, our students are making substantial progress in both graduating from high school and enrolling in college. Our Nation's on-time high school cohort graduation rate reached 80 percent in 2012—the highest in our Nation's history. And that is a testament to the hard work of our Nation's teachers, school leaders, students, and their families. College enrollment is up substantially as well since President Obama took office.

The bad news is that we still have unacceptable opportunity gaps in America, and it will be very difficult to close these gaps when Federal discretionary funding for education, excluding Pell grants, remains below the 2010 level.

Our international competitors are simply not making the mistake of disinvesting in education, and their students are making more progress than America's students, endangering our competitiveness and our prosperity.

In a knowledge-based global economy, closing these opportunity gaps and strengthening our competitiveness are among our most urgent challenges. Falling further behind would hurt our country economically for generations to come. So I appeal to all of you to continue America's longstanding bipartisan commitment to investing in education.

Despite the real educational progress we have made as a Nation, large opportunity gaps remain at a time where education is more important than ever to accelerating economic progress, increasing upward mobility, and reducing social inequality.

President Obama's budget would increase investigation in education to boost that progress and close those insidious opportunity gaps. Sadly, these opportunity gaps start with our youngest learners and early childhood education. Chairman Murray, this is where you began your career, and no one knows better than you how formative, how critical those early years are.

But the brutal truth, the honest truth, is that America is only 25th in the world—25th in the world—in our enrollment of 4-year-olds in preschool. Four in ten public school systems in the United States do not even offer preschool, setting the stage for a huge gap in school readiness, and that gap, as we know, too often never gets filled.

Outside of Washington, this has become a truly bipartisan issue, and, in fact, last year, in a very tough budget climate, 30 Governors—17 Republicans and 13 Democrats—increased funding for preschool in their State budgets. We applaud that leadership and that courage, and we need to help every State be able to make that same claim.

Ranking Member Sessions, obviously Alabama has done a fantastic job of increasing by about, I think, 50 percent their funding for preschool. And Mississippi, Senator Wicker, I think for the first time in its State's history, is investing in high-quality preschool. So, again, this has become an absolutely bipartisan issue in the real world away from the dysfunction here in Washington.

That is why the President's request for $500 million for preschool development grants and $75 billion in mandatory funding for the Preschool for All program are so essential. They would support the State-led efforts to provide access to high-quality preschool for all 4-year-olds from low-and moderate-income families.

State's attorneys, sheriffs, and police associations have come together to support high-quality early learning because it reduces crime when kids grow up. In fact, we have a letter here from over 5,000 leading law enforcement officials around the Nation supporting this effort.

Military leaders, admirals, and generals support it because a staggering three-quarters of young adults today are not fit to serve in a voluntary military because of educational shortfalls, poor physical fitness, or a criminal record. High-quality early learning reduces all of those problems.

Hundreds of tough-minded business leaders, CEOs, and chairmen of the board are big advocates as well because they know high-quality early learning produces a better workforce and has a high return on investment. That is a language that our Nation's CEOs absolutely understand.

Nobel Prize-winning economist James Heckman found a return of $7 to every $1 of public investment in high-quality preschool programs. I would ask everyone gathered here today, how many other uses of scarce taxpayer dollars have such a high rate of return for the American people?

Unfortunately, opportunity gaps in early learning continue all the way through high school, as new data from our civil rights data collection show. Today, students of color, students with disabilities, and English language learners simply do not get the same opportunity as their white and Asian American peers to take the basic math and science courses that figure so importantly in preparing for both college and careers. Often, this lack of access means students cannot take the classes they need to apply to a 4-year college.

Black and Hispanic students are close to 40 percent of high school students nationwide, but just over a quarter of students are taking AP classes and only 20 percent of those enrolled in calculus classes. And most schools today have nowhere near the bandwidth speed they need to support current applications and instruction.

Fully two-thirds of our Nation's teachers wish they had more technology in their classrooms.

In South Korea, which we all know is a very high performing nation educationally by every measure, 100 percent of schools have access to high-speed Internet. Here in the United States it is only about 20 percent. So 100 percent South Korea, 20 percent United States. As a result, our students, our teachers, and our schools often lack the bandwidth to take advantage of new technologies that could help to close those insidious achievement gaps and help to individualize instruction.

How is that fair to our children or to our hard-working teachers? How is that in our Nation's self-interest? Closing these opportunity gaps is the ribbon, it is the theme that runs throughout President Obama's 2015 education budget request. It is the overarching goal of the preschool development grants and Preschool for All. It is behind our request for a $300 million Race to the Top Equity and Opportunity Fund to help States and districts develop road maps to ensure that all students can reach their potential, and also our $200 million ConnectEDucators initiative to provide teachers with the expertise they need to use technology effectively.

By contrast, the Ryan budget in the House would widen, would increase opportunity gaps, cutting funding for education by an estimated 15 percent in 2016, or about $10 billion. If that 15-percent cut were applied this year, Title I funding for high-poverty schools and disadvantaged students would be cut by $2.2 billion. IDEA grants to States for students with disabilities would be cut by about $1.7 billion. That is exactly the wrong direction to go for our children and for our Nation's future. And that is absolutely contrary to the spirit that you have set to work through partisan issues in order to serve America's children well. You have shown that we can do better together.

The American dream has always been about opportunity. Today our Nation is failing to live up to that core American ideal for all of our citizens. We must do more to level the playing field and make a great education available to every child. That is who we are.

As former Florida Governor Jeb Bush says, the sad truth is that equality of opportunity does not exist in many of our schools, and that failure is the great moral and economic issue of our time, and it is hurting all of America. So let us get back to working together to close those opportunity gaps.

Thank you so much, and I look forward to your questions.

[The prepared statement of Secretary Duncan follows:]

## DEPARTMENT OF EDUCATION

**Statement by**
**Arne Duncan**
**Secretary of Education**
**on the**
**U.S. Department of Education Fiscal Year 2015 Budget Request**

Madam Chairman, Ranking Member Sessions, and Members of the Committee:

I want to begin by thanking Congress for your work on the 2014 appropriation for education. I appreciate the funding increases that you included in the fiscal year 2014 appropriation. However, it's important to recognize that total discretionary funding for the Department of Education, excluding Pell Grants, remains below the fiscal year 2010 level, and I worry about the long-term impact of the continuing slide in Federal education funding on the health of our economy and our democracy.

### PRESIDENT OBAMA'S 2015 BUDGET REQUEST

The overall discretionary request for the Department of Education is $68.6 billion, an increase of $1.3 billion, or 1.9 percent, over the 2014 level. Within this total, we have six key priorities: (1) increasing equity and opportunity for all students; (2) strengthening support for teachers and school leaders; (3) expanding high-quality preschool programs; (4) improving school safety and climate; (5) promoting educational innovation and improvement; and (6) ensuring access to affordable and quality postsecondary education.

### EQUITY AND OPPORTUNITY

We are requesting $300 million for a new Race to the Top – Equity and Opportunity competition centered on improving the academic performance of students in our Nation's highest poverty schools. RTT—Opportunity grantees would support: (1) developing systems that integrate data on school-level finance, human resources, and academic achievement; (2) developing and retaining effective teachers and leaders in high-poverty schools; (3) increasing access to rigorous coursework; and (4) other evidence-based activities that mitigate the effects of concentrated poverty.

### SUPPORT FOR TEACHERS AND SCHOOL LEADERS

A second priority in our 2015 request is to provide significant support for school teachers and leaders who are implementing new college- and career-ready (CCR) standards, turning around our lowest-performing schools, and using new evaluation systems to improve their practices. A key request in this area is $200 million that would help educators transition to using technology and data to personalize learning and improve instruction, in support of the FCC's ConnectED initiative to equip our Nation's schools and libraries with high-speed connectivity. The program would benefit educators and students by creating high-quality, open digital learning resources aligned to CCR standards; using digital tools to personalize learning and implement new assessments; analyzing real-time data to improve student outcomes; using technology to increase student engagement; and providing remote access to effective educators.

We are requesting $2.3 billion for Excellent Instructional Teams, which would provide both formula grants and competitive awards to help States and LEAs increase the effectiveness of teachers and principals. This total includes $2.0 billion for Effective Teachers and Leaders State Grants to provide flexible, formula-based support for States and LEAs; $320 million for the Teacher and Leader Innovation Fund to reform school leader advancement and compensation systems; and $35 million for a transformed School Leadership program to expand the Department's focus on current school leaders aimed at strengthening essential leadership skills.

## EXPANDING HIGH-QUALITY PRESCHOOL

The third major priority in the 2015 request is to continue the President's commitment to expanding educational opportunity for millions of children through a $75 billion mandatory Preschool for All program that would partner with States to support universal access to high-quality preschool for all 4-year-olds from low- and moderate-income families. Our preschool request also includes $500 million to expand the Preschool Development Grants program that would help build State and local capacity to implement high-quality preschool programs.

In addition, we are requesting $441.8 million for the Grants for Infants and Families program under the Individuals with Disabilities Education Act (IDEA), an increase of $3.3 million to help States implement statewide systems of early intervention services for all eligible children with disabilities from birth through age 2 and their families.

## AFFORDABILITY AND QUALITY IN POSTSECONDARY EDUCATION

Our 2015 request also includes key initiatives to improve affordability and quality in postsecondary education. For example, we are asking for $7 billion in mandatory budget authority over 10 years for new College Opportunity and Graduation Bonus grants to reward colleges that successfully enroll and graduate a significant number of low- and moderate-income students on time. This initiative would support innovations to further increase college access and success by providing funding to eligible institutions based upon the number of Pell students they graduate on time. The Satisfactory Academic Progress initiative would make changes to the Pell Grant eligibility provisions by strengthening academic progress requirements to encourage students to complete on time. The Budget would also provide Pell Grant eligibility to students who are co-enrolled in adult and postsecondary education as part of a career pathway program to allow adults without a high school diploma to gain the knowledge and skills they need to secure a good job.

Second, we would use $4 billion in mandatory funding to create a State Higher Education Performance Fund that would make 4-year competitive grants to States to support the successful implementation of performance-based policy and funding reforms that encourage and reward college affordability and ensure that students attend and complete postsecondary education.

Third, our 2015 request proposes $100 million to expand support for the First in the World fund to make competitive awards to support improving educational outcomes, including on time completion rates, and making college more affordable for students and families, particularly for low-income students. The request also asks for $75 million for College Success Grants for Minority-Serving Institutions, which would make competitive awards to minority-serving institutions designated under Title III and Title V of the Higher Education Act.

Lastly, we are continuing our efforts to help student borrowers with existing debt to manage their obligations through income-driven repayment plans. Our 2015 request proposes to extend Pay As You Earn, which caps student loan payments at 10 percent of discretionary income, to all student borrowers.

## EDUCATIONAL INNOVATION AND IMPROVEMENT

We continue to support innovation and improvement in elementary and secondary education, beginning with $165 million for Investing in Innovation (i3), an increase of $23.4 million, to maintain strong support for using an evidence-based approach to scale up the most effective approaches in high-need areas. The i3 request would provide up to $49.5 million for the Advanced Research Projects Agency for Education, an initiative that would pursue technological breakthroughs with the potential to improve the effectiveness and productivity of teaching and learning.

Second, we are requesting $150 million for a new High School Redesign program to support the transformation of the high school experience by funding competitive grants to school districts and their partners to redesign high schools to help ensure all students graduate from high school with college credit and career-related experiences or competencies.

Third, our 2015 request seeks $170 million in new funding for a comprehensive STEM Innovation proposal to transform STEM education. This total includes $110 million for STEM Innovation Networks to provide competitive awards to LEAs in partnership with institutions of higher education, other public agencies, and businesses to help increase the number of students who are effectively prepared for postsecondary education and careers in STEM fields. We also are asking for $40 million to support STEM Teacher Pathways that would make competitive grants for recruiting recent college graduates and mid-career professionals in the STEM fields in high-need schools. An additional $20 million would support the activities of a National STEM Master Teacher Corps, which would identify models to help America's brightest math and science teachers make the transition from excellent teachers to school leaders and advocates for STEM education.

In addition, the Budget provides a $100 million increase for Special Education State Grants. This increase would support Results Driven Accountability incentive grants to improve special education services for children with disabilities. States awarded these grants would identify and implement promising, evidence-based reforms while also building State and local capacity to improve long-term outcomes.

Our 2015 request also includes a request of $1.1 billion for a reauthorized Carl D. Perkins Career and Technical Education program. The reauthorization proposal would build on the experience of the i3 program by creating a discretionary fund aimed at promoting innovation and reform in CTE and replicating the success of proven models.

## IMPROVING SCHOOL SAFETY AND CLIMATE

The 2015 request would continue support for the Now is the Time school safety initiative by providing $50 million for School Climate Transformation Grants to help create positive school climates that support effective education for all students; $45 million for a Successful, Safe, and Healthy State and Local Grants program that would award grants to increase the capacity of States, districts, and schools to create safe, healthy, and drug-free environments; and $25 million for Project Prevent grants to help LEAs break the cycle of violence through expanded access, school-based strategies that prevent future violence.

## OPPORTUNITY, GROWTH, AND SECURITY INITIATIVE

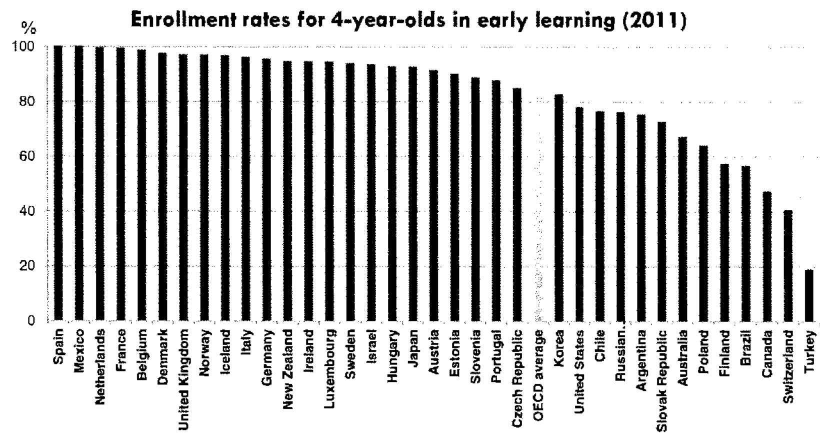
The Administration's Budget also includes a separate $56 billion Opportunity, Security, and Growth Initiative. Our Education Budget would use this initiative to include additional investments of $250 million for Preschool Development Grants, $300 million for the ConnectEDucators initiative, and $200 million for Promise Neighborhoods. All of these funds are in addition to the discretionary requests under the caps.

## CONCLUSION

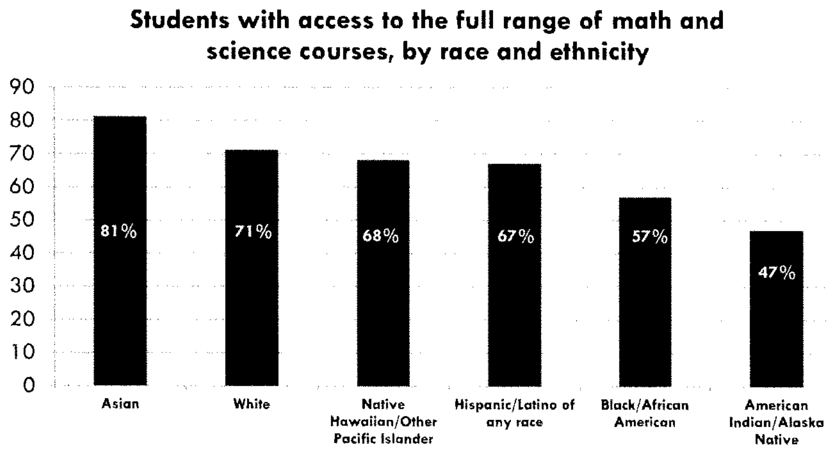
In conclusion, our 2015 Budget reflects the President's determination to make the investments necessary to secure America's future prosperity. I am happy to respond to any questions you may have.

# ACCESS TO EARLY LEARNING

THE UNITED STATES RANKS 25TH IN THE WORLD IN ENROLLMENT



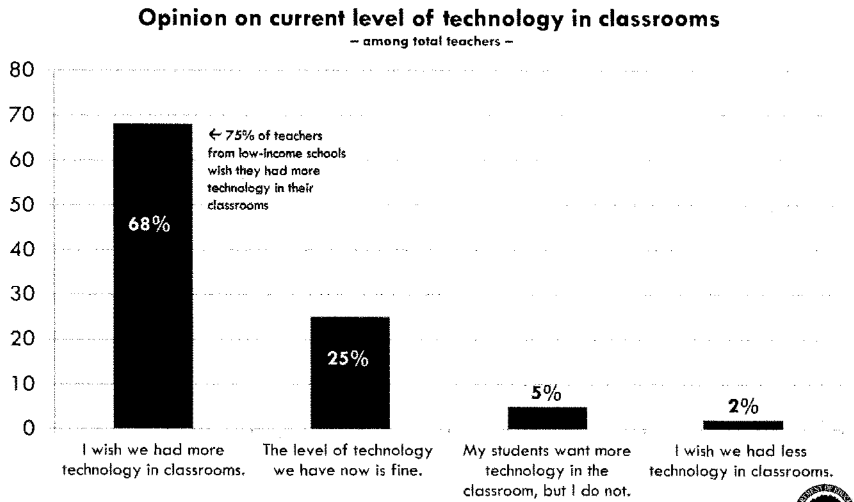
# LACK OF ACCESS TO THE FULL RANGE OF MATH AND SCIENCE COURSES




Full range of courses includes: Algebra I and II, geometry, calculus, biology, chemistry and physics.

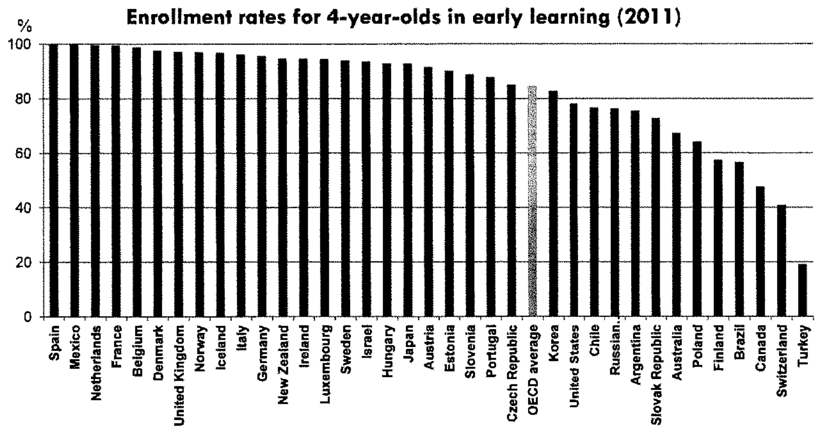
# AN UNMET NEED FOR TECHNOLOGY

## MORE THAN 2 IN 3 TEACHERS WANT MORE CLASSROOM TECHNOLOGY

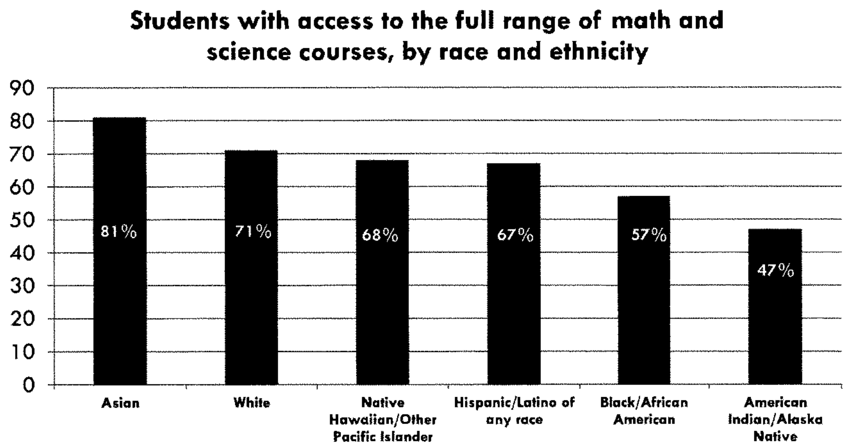


# ACCESS TO EARLY LEARNING

THE UNITED STATES RANKS 25TH IN THE WORLD IN ENROLLMENT



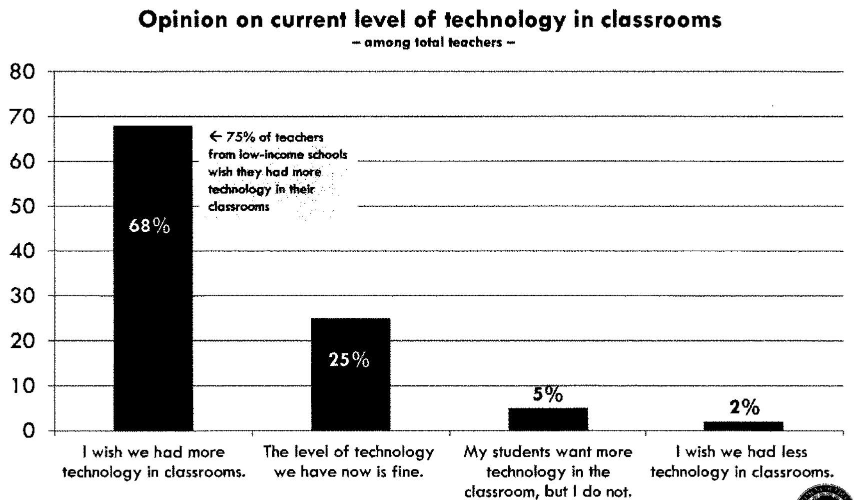
# LACK OF ACCESS TO THE FULL RANGE OF MATH AND SCIENCE COURSES




Full range of courses includes: Algebra I and II, geometry, calculus, biology, chemistry and physics.

# AN UNMET NEED FOR TECHNOLOGY

## MORE THAN 2 IN 3 TEACHERS WANT MORE CLASSROOM TECHNOLOGY



Chairman MURRAY. Thank you very much, Mr. Secretary.

Let me talk, first of all, about one of my top priorities, which is protecting servicemembers and veterans. I was really troubled by some recent allegations that Sallie Mae violated the Servicemembers Civil Relief Act with regard to student loans of military members, forcing servicemembers who are being deployed to pay higher interest rates on their loans and really ignoring the law altogether. And I understand now that several Federal agencies are investigating these accusations.

The Department of Education spends millions to contract with Sallie Mae. The Department has not yet levied any fines against the company and last fall indicated that it will renew Sallie Mae's contract despite these allegations.

Is that still the plan?

Secretary Duncan. Well, obviously all of us, I think, have not just an educational but a moral responsibility to provide our veterans with the best education possible. They have given up so much. They have sacrificed so much. The least we can do is to give them a chance to transition back to civilian life, get the education they need, and move on to the workforce. So there is an active investigation underway. I am not at liberty to comment on that at this point. Just know that we are partnering—we are working with the Department of Justice on that, and when that investigation is concluded, we will take those findings very, very seriously and act accordingly.

Chairman MURRAY. If Sallie Mae violated the law, will you pull the servicing loan contract?

Secretary Duncan. Obviously we will look at every avenue if laws are broken.

Chairman MURRAY. Okay. Is someone looking at the other student loan servicing companies to make sure this is not happening in other places?

Secretary Duncan. We absolutely have to do that, and our Federal Student Aid Office is doing that.

Chairman MURRAY. Okay. I will continue to watch that very closely. It is a high priority.

Secretary Duncan. It is a really important issue, and I appreciate your attention to it.

Chairman MURRAY. Okay. Mr. Secretary, after reviewing the administration's entire fiscal year 2015 budget request, it is pretty clear that education is one of the President's top priorities. In fact, your budget requests an increase of $1.3 billion, as you mentioned.

I really applaud that focus. However, you and I both know that investments in education are trending downwards at the Federal, at the State, and at the local levels. So can you just talk to us a little bit about the long-term economic impact that could occur if our country continues to disinvest in our students?

Secretary Duncan. I just think, again, Senator Murray—and everyone here knows this, Chairman Murray—that we live in a globally competitive economy; we live in a flat world, and high-paying, middle-class, high-wage, high-skilled jobs are going to go to where the most educated workforce is. And I think everyone here desperately wants that to be in our communities, in our States, and in our country, and not in other countries.

But businesses can move where those knowledgeable workers are, and I look at every level, and, quite frankly, at no level right now are we as a Nation where we need to be. So we talked about the early childhood side where we rank about 25th in the world in providing that opportunity. Again, no one knows this better than you, but for so many of our children coming from disadvantaged communities, the average child coming from a poor community starts kindergarten in the fall a year to 14 months behind—the average child. And far too often, frankly, we never catch up.

So we have to, you know, get out of the catch-up business. We have to level the playing field. The fact that we are 25th in the world, that is no badge of honor. That is early childhood.

On the K–12 side, on the math and science rankings, we are somewhere usually between 15th and 30th. We are nowhere near where we need to be, again, if our goal is to be number one.

And then, finally, I think we can all unite behind the goal of leading the world in college graduation rates. That seems to be in all of our mutual self-interest. One generation ago, we were first in the world. Today we are 12th. And it is interesting. It is not that we have dropped. It is that we have stagnated, we have flat-lined, and 11 other countries have passed us by.

So you look at early childhood, you look at K–12, you look at higher education. None of these—none of these—are where we need to be. Now, we are making some progress. I talked about how high school graduation rates are up, college enrollment is up. Those are positive trends. But we are so far from where we need to be. All of us, regardless of politics, regardless of ideology, all of us have to work together to lead the world in education success, and to do that it cannot just be a little tweak. We have to get better faster. We have to work together in ways that put aside politics and ideology.

Chairman MURRAY. Thank you. I really appreciate that response, and you are continuing to give that message everywhere. I think that by ignoring what is happening globally, we are going to lose out dramatically in the future, so I appreciate that.

You have talked about early childhood education. You know that is a passion of mine. I really believe that an expansion like the one that we do envision in the Strong Start for America's Children Act would make significant strides in helping us close the opportunity and achievement gaps that we are seeing. But I continually hear from some of our friends on the other side that we have too many Federal learning programs.

I wanted you today to talk and give us a little better understanding of the current unmet need for early learning opportunities and how the proposal in your budget is not duplicative of existing Federal programs.

Secretary Duncan. And I think, again, all of us can unite that where we have, you know, duplicative efforts, where we are wasting money, we should not do that. But at the end of the day, we want to go from about a million young children with access to high-quality pre-K to 2.2 million, so we want to double that. And you cannot do that without increased investment. And, we have to make sure this is not just access. We have to make sure this is about high quality. We have to hold ourselves accountable. I am actually proud of HHS and my friend Kathleen Sebelius. They are making folks recompete on the Head Start side, so it is not business as usual there. But there is tremendous unmet need.

This would not be any kind of Federal mandate or top-down thing. We simply want to partner with those Governors—again, more Republicans Governors than Democrats today, and we think that is fantastic—who are investing. What breaks my heart, Chairman Murray, as I have traveled the country and we do these very unusual meetings, public meetings with CEOs and military leaders and heads of the chambers of commerce, faith-based community, in virtually every State I go to where Governors are putting their scarce tax dollars behind increasing access to early learning, there are still waiting lists of 6,000, 10,000, 12,000, 15,000 kids. So these are families who want to do the right thing, who are looking to have their children be prepared to enter kindergarten, and we collectively as a Nation simply are not providing those opportunities. This is not good enough.

Chairman MURRAY. So expanding the Federal program will help support those Governors who are providing it to make sure that more kids get served.

Secretary Duncan. It would just be a partnership. States would—you know, if they want to extend their reach, leverage our resources with their resources, they will have that opportunity. If they do not want to do that, they would have the right not to do that. But I cannot tell you how many Governors have said, you know, “We are working hard here. We are trying. We need help.” And, again, this is Republican and Democrat.

Chairman MURRAY. And I think sometimes we forget how mobile our families are today, so if you have a couple States or half a dozen States that do really well, they have got kids coming in every day that have come from States that have not focused on this, and that is why I think we have a national level. I assume you would agree.

Secretary Duncan. And, again, I meet with these education ministers from all over the globe, met with the minister from Japan last week, met with the minister from Finland yesterday, and quite honestly, it is embarrassing, it is humiliating. They are stunned that we do not care more about our babies than we do, and they sort of ask me, “Why isn’t this a national value?” And I do not have a good answer for them.

Chairman MURRAY. Okay. Thank you. I really look forward to working with you on all these issues.

Senator Sessions?

Senator SESSIONS. Thank you. I would yield to Senator Grassley.

Senator GRASSLEY. I only have two questions, so I may not take the full 7 minutes.

Secretary Duncan, I have written to you before about the fact that the waiver provisions in No Child Left Behind do not authorize you to add requirements that do not exist anywhere in the law. And I still believe that that exceeds your authority.

Now, I am not going to get into that here, but I do want to ask you about one of those waiver requirements. Your Department’s waiver application requires States to have “college-and career-ready standards” in place. That is defined as either “standards that are common to a significant number of States, or standards that are approved by a State network of institutions of higher learning."

As you know, the first option can only be met by adopting the Common Core standards. However, you or others in the administration have made a point of saying that adopting Common Core is not a requirement for a waiver because of Option 2.

My question: What happens if a State pulls out of Common Core, as Indiana just did, given that you have pointed to this other option to argue that you are not pushing Common Core on States? Will States that pull out of Common Core automatically get to keep their waivers, assuming they are able to get the required sign-off from their State higher education institutions and continue to meet other criteria? If not, why not?

Secretary Duncan. Yes.

Senator GRASSLEY. Okay. The second question: As you know, the No Child Left Behind Act requires schools to bring all students up to a proficient or higher level of achievement by the end of the 2013–14 school year. While no State is in a position to attain this goal, Iowa is one of a few States that were not granted waiver of this requirement by your Department. We are now at a point where virtually every school will be labeled "a school in need of assistance" and required to undertake corrective action. That will put the Iowa Department of Education in the impossible position of having to assist hundreds of schools in Iowa with reforms, not to mention the administrative burden on many Iowa schools that have high levels of achievement but short of the 100-percent goal.

What guidance will you give to non-waiver States like Iowa on how to prioritize actions and minimize disruption to student learning, given an impossible task?

Secretary Duncan. So we are happy to work with Iowa and with your Governor, whom we have a great relationship with, going forward. As you know, we have provided waivers to about 44 States, again, across the political spectrum—left, right, Republican, Democrat. We have worked with virtually everybody. That was always Plan B. So we will partner with Iowa in the current situation.

I would just urge you to join with Chairman Murray and with your fellow Senator from Iowa, Tom Harkin. The best thing we can do as a Nation would be to fix the law and to fix it together in a bipartisan way.

Senator GRASSLEY. I agree with you on the latter point.

Secretary Duncan. We have had to step in due to Congress' dysfunction, and if Congress could do their job, we would back right out in a heartbeat.

Senator GRASSLEY. Now, I hope that when you say you will work with States, that is something that is practical to do, because I think you have been a little bit vague in this whole advice to States, if they do not have the waiver, what they can do.

Secretary Duncan. So I beg to differ, and we will be as clear as we can. Talk to your Governor, talk to your State education agency. We have, I think, had very, very good relationships with the overwhelming majority of Governors and SEAs across the country and have partnered, honestly in a pretty remarkable way. Given all the dysfunction here in Washington, to have 44 States partnering directly with us is a big accomplishment and you hear very little noise, you feel very little drama. We listen, we work together, we challenge each other, we hold each other mutually accountable. And I am pretty proud of—we have not done it perfect, we make mistakes every day, but we are actually pretty proud of how we have functioned so well.

Senator GRASSLEY. Okay. I will look forward to you working with our State. Thank you very much.

Secretary Duncan. We will continue to do that.

Senator GRASSLEY. Thank you. I am done. I yield back my time.

Chairman MURRAY. Okay. Senator Whitehouse?

Senator WHITEHOUSE. Thank you, Chairman. Welcome, Secretary Duncan.

Secretary Duncan. Good to see you.

Senator WHITEHOUSE. I am not an education expert. I was a prosecutor, and my first connection with the education system was the realization that our middle schools were the opening to a pipeline that ended in my office and in a courtroom with a juvenile prosecution. And so for a long time, I have tried to learn more about this, and I have a group of friends and colleagues and advisers in Rhode Island who live education. They work in charter schools. They lead reform initiatives. They are involved with public school teacher unions. They are classroom teachers. It is a broad array of experience from a variety of different perspectives.

And what has struck me now is that one area of agreement across all that array of people is that the education oversight establishment as a collective creature has become so burdensome that it is now interfering with classroom teachers' ability to manage their classrooms and local schools' ability to direct their local affairs. And I was a little bit surprised by that because I did not expect that to be so uniform and so forceful a belief.

But it is not outside of the human experience for an industry or a bureaucracy to come to the point where it begins to propagate itself and the mutualist relationship becomes a parasitic relationship.

What are you doing to analyze that question? And are you committed to a model where control comes from the top down? And how much room is there to maneuver with really local, like school-specific innovation as opposed to innovating with Governors who are, you know, responsible for a massive amount of the bureaucracy and deal at a very high level in the system?

Secretary Duncan. So it is a real issue, and as you know, what teachers and parents and students feel is not just one bureaucracy but multiple bureaucracies.

Senator WHITEHOUSE. Yes. Wherever they look, there is more being thrown at them.

Secretary Duncan. There is State and Federal, and they do not care where it is coming from. It is just more of whatever. So it is a real issue. We are absolutely committed.

I say everywhere I go, where people have specific challenges with our bureaucracy, to let us know when we are asking for redundant information, when we are asking for useless information, to please let us know. We have tried to do lots of things ourselves. We have streamlined the waiver process in direct response to hearing from folks. In IDEA, the burden of data collection has been pretty high.

Under our revised SPP/NPR, we have eliminated reporting on 4 compliance indicators and th e need for States to develop 20 separate improvement plans instead of a single comprehensive plan. So we are really working.

I am sure we have a long way to go, so, again, where folks have concrete recommendations, please feed those to me directly, hold me accountable. This work is so important, it is so serious. I love that we have an 80-percent graduation rate. I stay up at night worrying about those 20 percent of young people who are not graduating and what they are going to do with their lives. And I want teachers and principals, all their time and energy, thinking about how to improve educational outcomes, not how to fulfill some request from me or someone else. So we want to be a good partner. We have tried to take some very concrete steps, we are open to more.

The other one that we are early on, but just to talk about for a minute, is I think part of what we see in funding-silos at the State and local level. Those silos reflect silos that we have had in our agency, so a Title I funding source and a Title II funding source and a Title III funding source. And what we are trying to do is move away from funding streams, we are trying to move to a model of State desks and State support for the entire State or for the district, and have a much more holistic approach to this. And so we are hoping—and we are early on in this, you know, in our infancy, so we are still trying to map it out. But we are hoping if we can change our behavior and model to something different that that will have pretty significant ramifications at the State and the local level and start to remove some of those real barriers, those impediments.

Senator WHITEHOUSE. In addition to the direct burden of compliance with that whole array of oversight burden, schools and school districts also often have to spend scarce resources on consultants and experts who they bring in to help negotiate all that bureaucracy for them. And I am wondering if you are aware of anyone who is looking at what the total burden is, not just of the schools' internal compliance with it and not just of the cost of all of that bureaucracy, but also of that private sector component that exists to help schools navigate that bureaucracy, but is in itself a burden to those schools.

Secretary Duncan. Yes, there are a couple—let me come back to you on the details. There are a couple States that are looking at that. And this is a little bit off topic, but I just want you to know sort of where our thinking is.

So one area—two quick areas. Sorry. One is in the area of special education. That has been, in my mind, a very compliance-driven entity, and it is interesting to me that once you are labeled as a special needs child, that label almost never gets removed. That stays with you for life. So how do we help move children out of special ed; how we prevent more children from going into special ed? The person who is leading our shop there, Michael Yudin, is very, very thoughtful, and he is moving towards results-driven accountability and also looking at what we are doing around high school graduation rates and to help more young people to go on either to the workforce or to higher education. So we feel very, very good about that.

And the area where I think that there has been way too much emphasis on the private side is our Title II money, professional development money for teachers. We are asking so much of teachers. We owe it to them to give them great professional development, and that is absolutely the exception. That rarely happens. We spend at the Federal level $2.5 billion each year that goes out there. When I say that to teachers, they usually laugh or cry. They are not feeling the impact—

Senator WHITEHOUSE. I have got about 10 seconds left.

Secretary Duncan. Okay.

Senator WHITEHOUSE. So let me just say that I hope that you keep in your heart, as you go about your job, these teachers and these local school administrators who are feeling stifled and frustrated by this compliance-driven regime that they are forced to live in. And if we can unpack some of that, I think we will do them a lot of good.

Secretary Duncan. So we are trying to unpack it, and, again, any concrete recommendations you or your team has, please feed them to me directly.

Chairman MURRAY. Senator Sessions.

Senator SESSIONS. I will yield to Senator Wicker.

Senator WICKER. Thank you. Thank you very much. And, Mr. Secretary, thank you for your participation today. I have had to be in and out of the room. I understand while I was out of the room you mentioned Mississippi's new preschool program. It will begin this September with a relatively modest $3 million State investment. I assume you meant that as a compliment.

Secretary Duncan. Highest compliment.

Senator WICKER. Thank you,

Secretary Duncan. And thrilled you guys are in the game. We would love to see you do more. You and I know the challenges of children there, and getting them off to a better start, I cannot overemphasize how important that is.

Senator WICKER. Thank you.

Secretary Duncan. We really appreciate the Governor's leadership.

Senator WICKER. It is my understanding that the Governor proposes to do that without additional Federal funds, and I would just observe, before I go on to my question, that it is my understanding the President's Preschool for All program would add to some 45 existing Federal early childhood programs. Let me just make that observation. You can respond later, if you would like to.

You also quoted with approval former Governor Jeb Bush, I believe, and saying that we have a real problem with opportunity in our education system. And, of course, so much of that comes from failing school districts. Those are districts I would not send my children to. Those are districts that the President of the United States chooses not to send his children to, in so many areas, whether it is achievement or just basic safety of the children. And it just seems to me that we are more and more a society that believes in choices. And from consumer goods to Internet providers to flavors of coffee to whatever, we want a wide variety of our choices. And one of the areas in which we have not empowered families and parents to make the best choices for their children is in the area of choosing to place their children in better opportunities without having to pull up and move the whole family. So I would make that observation.

But here is my question, and it deals with the proposed rule the Department of Education released in March on the issue of gainful employment. Now, it is my understanding this has been a statutory phrase for some 40 years, but the new rules, an 845-page regulation, proposing to define the phrase "gainful employment" seems to many of us, Mr. Secretary, that you are discriminating against vocational programs, you are discriminating against for-profit colleges, and some community colleges by defining meeting the gainful employment requirement as a program in which students have a debt-to-earnings ratio below 12 percent 2 years after graduation.

I think this singles out the sort of for-profit college and university that is a gateway to the middle class for minorities, for veterans, for other underserved demographics. And so I would like you to respond to that. Why do we single out vocational? Why do you— and do you, as I understand, exempt the more traditional colleges?

For example, if this metric were used at private nonprofit colleges, 39 percent of students would not meet this metric. If it were used at the traditional 4-year public institutions which I attended, 26 percent of graduates would not meet this metric.

There were other metrics which could have been used, and I would like for you to comment about why you did not go in that direction, such as placement rates, graduate study, passage of licensure exams, things of that nature. So why that metric? Aren't you, in fact, discriminating against for-profit colleges? And why not use these other definitions.

Secretary Duncan. Two good questions. Let me start on early childhood first, and, again, just give your Governor, Governor Bryant, tremendous credit for investing.

Senator WICKER. Thank you.

Secretary Duncan. The question I would have for you and for the State is, what is the unmet need in Mississippi. How many additional 3-and 4-year-olds do not have access to high-quality early learning? And you and I know that by virtually every measure, sadly, Mississippi ranks near the bottom nationally—you know, 48th, 49th, 50th on many, many measures, and I just do not think that is fair to your children or to your State or to your State's economy. And whatever we can do to work together to have more children entering school ready to be successful, we want to do that. So I'mm thrilled with the investment. As you said—

Senator WICKER. Thank you for that bit of highest praise.

Secretary Duncan. But let us work together. Great starting point but not a finishing point, and let us figure out how we do that.

Just quickly, the challenge on the gainful employment side is obviously Congress defined "gainful" there, and we just want to make sure that the right thing is happening for taxpayer dollars. To be very clear, where for-profits institutions are helping to prepare people for real jobs that have good wages and help move them up the economic ladder, we want to see them grow, we want to see them thrive, we want to see them prosper, we want to see them serve more students.

But the fact of the matter is that today students at for-profit colleges represent about 13 percent of total higher education population but almost half, 46 percent, of loan defaults. So 13 percent of enrollment, 46 percent of loan defaults. So we need to just make sure that we are rewarding those players that are acting in good faith and helping them do well. But the challenge I think we have, Senator, is when people are taking advantage of the disadvantaged, burdening them with debt, and there are no jobs or no high-wage jobs, and they end up in a worse economic position than when they started, that is something I think none of us can support.

I want to read you a quick quote. It says, "You will find accounts of semi-literate high school dropouts lured to enroll in expensive training programs with false hopes for a better future cruelly dashed. You will read of falsified scores on entrance exams, poor-quality training, and harsh refund policies. The pattern of abuses revealed in these documents is an outrage perpetuated not only on the American taxpayer but, tragically, upon some of the most disadvantaged, most vulnerable members of society. The kids are left without an education and with no job and the taxpayer holding the bag for a kid who got cheated."

That did not come from me or this Administration. That came from Secretary Bennett, who was President Reagan's Secretary of Education in 1988. And so I think this is something to be addressed in a bipartisan way. Scarce taxpayers dollars are funding these programs—where we get a good return on investment, we should help them. Where we do not have a good return, we should challenge the status quo and do that together.

We are at a time right now of public comment. We put out a draft. We put out the draft with great humility. And where folks have better ideas, we are absolutely willing to listen. But to do nothing, to accept the status quo where 13 percent of enrollees are leading to half of our Nation's defaults, I think we can do better together.

Senator WICKER. It seems to me—and we have a vote on, so I have to be very, very brief.

Chairman MURRAY. We do have a vote, and we want to finish.

Senator WICKER. But when you do not apply it to every institution of higher learning, and when there is a 26-percent failure rate in 4-year institutions, 39 percent in private nonprofit colleges, it seems to me we are singling out one sector. And I would trust consumers to sort this out over time and choose the good colleges which get placement, graduate study, and licensure—

Chairman MURRAY. Senator Wicker—

Senator WICKER. —and leave it to the private sector.

Chairman MURRAY. Senator, I really appreciate your—

Senator SESSIONS. Thank you.

Chairman MURRAY. But we want to make sure Senator Sessions has a chance to speak before the vote ends here and we both get called out. So, Senator Sessions, you will be our last—

Senator SESSIONS. Thank you. Thank you, Madam Chairman.

I was looking at some of your reforms in the Department of Education, and not a lot of money, but you did eliminate a number of programs that looked like some politician passed 25 years ago that do not really contribute to the overall improvement of education in America, so I salute you for doing that. We need more of that in Government. We have just got to eliminate some of these small niche programs that do not provide national impact.

With regard to priority setting, I would say to you, Mr. Duncan, that the President has signed a limit on spending. I would say to you that if you need more education funding, the President should propose altering his discretionary spending accounts and put more in education. But just to spend more above the limits we have agreed to is not going to be good.

Now, we are in a tight budget time, as you know, and we looked at the interest rates that I just mentioned to you, the size of our deficits. Dr. Elmendorf in your chair a few months ago told us we are on an unsustainable path financially.

Okay. So I do not think it is fair to say we are disinvesting in education. If you look at Pell grants, which make up about a third of what we spend, Pell grants went from $18 billion in 2008 to your proposal of $32 billion next year. That is an entitlement program, not a discretionary program, but are those numbers accurate?

Mr. SKELLY. Those numbers are accurate, Senator. The number of recipients also went up over 50 percent. That is the driver of the cost.

Secretary Duncan. And just one quick point on that. We went from about 6 million Pell recipients to almost 9 million, a 50-percent increase, a $40 billion investment, without going back to taxpayers for a nickel. We simply stopped subsidizing banks, made the loans ourselves. That was wildly controversial here in Washington. We thought it made common sense. That is an additional almost 3 million young people who may not have had the chance to go to college without those dollars.

Senator SESSIONS. Well, we will test that out, and maybe it will work. I hope so.

Secretary Duncan. It is working.

Senator SESSIONS. All right. And in 2008, the Department of Education budget was $59.2 billion. That is your base budget. And you are proposing next year a $68.6—increasing to $68.6 billion, which is, I think, a 15-percent increase. But there was only one year, last year I guess, where you had an actual reduction.

Now, that is a result of the Budget Control Act and the sequester. So in 2012, you were at $60 billion; at 2013, you were at $68.3; post-sequester, you were at $65.7, about a $2.6 billion reduction. So that was a cut in your base budget. Pell grants going up, but your base budget did take a reduction.

Now, isn't it true that after next year your budget will increase at 2.5 percent a year under the Budget Control Act?

Mr. SKELLY. Unfortunately, in 2016, we revert to the sequester levels, the bipartisan—

Senator SESSIONS. I know, but the sequester level—maybe 2016 is flat again. But 2017, under the sequester, you get a 2.5-percent increase each year thereafter?

Mr. SKELLY. I wish we did get that. My understanding, Senator, is that we will drop down, almost off another cliff, in 2016 and future years in discretionary appropriations.

Senator SESSIONS. We will have to look at that number. My impression is under the Budget Control Act that after the cuts were impactful in the last 2, 3 years, this year, you have got tight budgets, you do begin to have some inflationary rate of increase in the future.

Secretary Duncan. I think your understanding is wrong there. I wish it was, but I do not think that is correct.

Senator SESSIONS. All right.

Chairman MURRAY. We can make that happen.

[Laughter.]

Senator SESSIONS. Well, you have improved the budget for—we spent more in the Ryan-Murray than we originally agreed. But it was a tight time because this was the worst year in the whole Budget Control Act period, and it was definitely a painful process.

I guess my first point is, as of to date and expecting next year, you are not really taking big cuts. Since President Obama has been in office, you have increased spending. And that does not count the stimulus bill, which was $97 billion for the Department of Education. Divided over this 6-year period, that would be another $14 billion above what your base budget is.

So I just want to say, first of all, the Education Department has not been savaged. You are having some tough times. The growth rates you would like to see have not been accomplished. But this is not a savaging of the Education budget, in my opinion.

Now, you and I talked previously about Alabama's reading initiative and its math and science initiative. It was developed in-State—Madam Chairman, it is really interesting. Katherine Mitchell studied all the studies about reading, and she crafted a reading program that emphasized proven techniques to improve reading. And they would have a reading coach for a school. It would start in kindergarten through the sixth grade. And all the teachers were coached in how to build on the previous year's teacher's processes. And they were taught to use these techniques.

And, you know, people do not like testing, but the way they did it was they are testing constantly, and they are knowing where a child is falling behind immediately and helping them up, not just at the end of the year and say, "You failed."

So it seems to me that did not cost a lot of money, but Alabama led the Nation in improved reading scores statewide several years ago.

Could we do more of that? Couldn't you use more of the Federal money to research techniques of teaching to help teachers in that classroom do better?

Secretary Duncan. So if we had more research money, we would be happy to do that. Just to be very clear, I think what Katherine and her team did was remarkable. And I talked earlier about how poorly teacher professional development money is often used. Well, I think they used their State money and our Federal money in some very thoughtful ways.

As you know, we cannot mandate that. We do not want to do that from Washington. That is best done at the State level. But this was strong State leadership. This was not let a thousand flowers bloom. It was we are going to work together, we are going to be on the same page, this is going to be tough-minded. And the results speak for themselves, and the State should be proud of that.

Chairman MURRAY. All right. Thank you to everyone who participated today. Secretary Duncan, thank you very much. We are late for a vote. We are going to run. But I appreciate what you have contributed and look forward to working with you on these critical investments.

I want all of our Committee members to know that Federal Reserve Chair Janet Yellen will be here Thursday to testify. The hearing starts at 9:30 a.m. Any additional statements or questions for the record are due in today.

Thank you very much.

[Whereupon, at 11:33 a.m., the Committee was adjourned.]

## QUESTIONS SUBMITTED BY SENATOR ANGUS S. KING, JR.

### RURAL COMMUNITIES AND CONNECTED

*Question.* I remain concerned by the Administration's focus on allocating funding through competitive grants. While currently only 10 percent of the Department of Education's budget is devoted to competitive grants, the Fiscal Year 2015 Budget proposes to ramp that percentage up to 16 percent. To account for this increase, the Department proposes flat-funding and in some cases reducing formula funding sources for programs like ESEA, Title I and IDEA. Formula funds are essential to rural States like Maine; lacking the administrative infrastructure to apply for competitive grant programs, we often fare poorly in these competitions.

To this point, while I commend your Department's commitment to providing professional development grants through the Budget's proposed ConnectEDucators initiative, I am concerned with the proposal's choice to use competitive grants to distribute funds. Rural districts are less likely to have current access to the level of bandwidth that ConnectED seeks to provide, meaning that rural teachers are less likely to have experience with broadband-enabled teaching methods. How will your Department ensure that rural teachers receive sufficient support as they work to take full advantage of the large increases in bandwidth that their classrooms will see under ConnectED?

Answer. ConnectEDucators is specifically designed to complement the ConnectED initiative by helping to give educators the skills they need to take advantage of high-speed networks and related devices to improve instruction for students. Applicants will receive points not for their experience with broadband teaching methods, but for their high-quality plans to use technology and data to meet local needs, including support for the transition to personalized learning and instruction aligned to college- and career-ready standards. We have been increasingly successful in structuring our competitive grant programs to maximize opportunities for rural applicants, through such approaches as the use of competitive preference priorities for applicants serving rural areas and schools, and we are confident we can do the same under ConnectEDucators. Moreover, it is important to note that our ConnectEDucators proposal includes both formula and competitive grants, with formula funds aimed at increasing the capacity of all States to support the transition to digital learning.

### REFINANCING OUTSTANDING STUDENT LOANS

*Question.* Total outstanding student debt has reached $1.2 trillion; evidence suggests this is a drag on the economy. The President's Fiscal Year 2015 Budget Request includes some sensible reforms to existing income-based repayment programs that would ensure that borrowers do not have to pay more than their income permits and also eliminate the tax liability for forgiven debt.

Some lawmakers have suggested we should also allow borrowers to refinance this debt at a much lower interest rate, a proposal that could be both costly and poorly targeted. What is the Department's position on allowing borrowers to refinance outstanding student loans? Is the Department interested in working with Congress to pursue moderate reforms to existing income-based repayment programs that would simplify options for borrowers and better target debt relief?

Answer. The Department's priorities are clearly stated in its fiscal year 2015 budget proposal, where, as you mention, we seek to make sure that students and families have an easy-to-understand insurance policy against unmanageable debt now and in the future by extending the Pay As You Earn (PAYE) repayment plan to all student borrowers, regardless of when they borrowed. The budget also would reform PAYE to ensure that program benefits are targeted to the neediest borrowers and to safeguard the program for the future, including by protecting against institutional practices that may further increase student indebtedness. The Department looks forward to working with Congress in advancing its budget, including this proposal.

On June 9th, President Obama signed an executive order directing the Department to take specific action to help struggling borrowers manage their debt. These actions include: expanding the PAYE plan to borrowers not currently eligible; improving communication and outreach to borrowers, especially those who have left school without a degree, those in default (particularly those with low outstanding balances), and borrowers who have missed their first loan payment; partnering with private-sector tax preparation and other entities to promote awareness of repayment plans during tax season; and, piloting research to examine the effectiveness of loan counseling resources, and collaborating with organizations, researchers, and individuals to identify effective loan counseling mechanisms and raise awareness about borrowers repayment plan options.

President Obama has also stated his support of Senator Elizabeth Warren's bill, which would allow millions of borrowers the option to refinance their Federal and private student loans at current, lower interest rates.

## EXPERIMENTAL SITES PROGRAM

*Question.* In March, I wrote a letter to you describing Maine's Bridge Year program, a pilot dual enrollment program that allows high school students to receive up to 30 credits during their junior and senior years and complete an associate's degree in 1 year's time. I'm glad to know the Department is considering expanding its Experimental Sites authority to consider funding efforts like these that improve student success and shorten time to degree. When will the Department announce its specific plans for expanding its Experimental Sites authority?

Answer. In August 2013, President Obama outlined an ambitious new agenda to combat rising college costs and make college affordable for American families. One of the components of the President's plan is to remove barriers that stand in the way of innovations in higher education that promote postsecondary access, program completion, and high-quality, affordable education programs. (For more information see: www.whitehouse.gov/the-press-office/2013/08/22/fact-sheet-president-s-plan-make-college-more-affordable-better-bargain-). In support of the President's agenda, the Secretary will use his authority under section 487A(b) of the HEA to grant waivers from specific Title IV, HEA statutory or regulatory requirements to allow a limited number of institutions to participate in experiments to test alternative methods for administering the Title IV, HEA programs. The President's Budget requests funding to conduct research, evaluations, and demonstrations related to these experiments. While the Department has not yet set a formal announcement date, we will consider each of the submissions we received in response to the December 2013 Federal Register notice as we design experiments.

## HIGH SCHOOL STUDENTS AND PELL GRANTS

*Question.* How does the Department plan to allocate resources to these programs, and is the Department considering allowing high school students enrolled in these programs to be eligible for Pell Grants?

Answer. In December 2013, the Department published a notice in the Federal Register inviting ideas for experiments designed to test alternative ways of administering the student financial assistance programs, and identified a number of potential areas of interest including allowing high school students to receive Federal student aid (which includes the Pell Grant program) for enrollment in postsecondary coursework (http://ifap.ed.gov/fregisters/attachments/FR120613.pdf). While the Department has not yet set a formal announcement date, we will consider each of the submissions we received in response to the Federal Register notice as we design experiments.

## EARLY CHILDHOOD EDUCATION PROGRAMS

*Question.* In response to the President's Fiscal Year 2014 Budget Request, the Murray-Ryan Budget Agreement allows for the allocation of $250 million in grants to States to enable them to develop, enhance, or expand early childhood education programs. Maine plans to ramp up its public preschool programs over the next several years, and Federal funds would be very helpful in supporting this expansion. When do you expect the details of this competition to be made public?

Answer. The Department plans to use the $250 million provided for early childhood education in the fiscal year 2014 appropriations act to implement a Preschool Development Grants program that will include two separate competitions: (1) a Development Grants competition that would help States and local communities to build or enhance the preschool program infrastructure needed to enable the delivery of high-quality preschool services to children; and (2) an Expansion Grants competition that would support efforts to scale up high-quality preschool programs in targeted communities. On May 5, 2014, the Department posted executive summaries describing the proposed Development Grants and Expansion Grants competitions on its Web site and invited public comment. The Department expects to publish Notices Inviting Applications later this summer.

## EARLY CHILDHOOD EDUCATION FUNDING FOR RURAL DISTRICTS

*Question.* Do you anticipate a specific allocation of funds to be devoted to rural districts?

Answer. No; consistent with the requirements of fiscal year 2014 appropriations language, the Department will award Preschool Development Grants to States, not districts. However, States must make subgrants to early learning providers to build, develop, and expand voluntary, high-quality preschool programs that serve 4-year-olds in high-need communities, and the Department has emphasized that these communities may be rural communities.

## QUESTIONS SUBMITTED BY SENATOR SHELDON WHITEHOUSE

## COLLEGE OPPORTUNITY AND GRADUATION BONUS GRANTS AND PELL GRANTS

*Question.* Low-income students must rely increasingly on Federal student loans to pay for college, especially since the size of the maximum Pell Grant has stagnated over the past few decades (although the average Pell Grant has increased modestly). In the Fiscal Year 2015 Budget, the President is requesting $7 billion in the mandatory budget over a period of 10 years for new College Opportunity and Graduation Bonus grants to reward colleges that enroll and graduate a substantial number of Pell students. Instead of allocating this money to institutions, why not use these funds to increase the size of the Pell Grant?

Answer. The Administration is strongly committed to the success of the Pell Grant program, as evidenced, in part, by supporting the increase in the maximum Pell Grant award to $5,730 for the 2014-15 award year — a nearly $1,000 increase since 2008. Under the President's leadership, the number of Pell Grant recipients has expanded by 50 percent over that same time, providing college access to millions of additional low-income and middle-class students across the country. The Obama Administration's landmark investment in Pell was enacted in the Health Care and Education Reconciliation Act of 2010, which ended student loan subsidies for private financial institutions and banks and shifted over $60 billion in savings back to students.

With a focus on the issue of college affordability – in accordance with the President's vision of leading the world in college attainment rates by 2020 – the Fiscal Year 2015 Budget provides sufficient resources to fully fund the $5,830 maximum Pell Grant award in the 2015-2016 award year. In addition to fully funding the Pell program in fiscal year 2015, this Budget seeks to address the long-term Pell funding gap by expanding and modernizing the Perkins Loan program and converting it to a mandatory credit program. The savings associated with this proposal would offset corresponding increases in the mandatory budget authority needed to maintain a fully funded Pell Grant program. This important reform to Perkins Loans will ensure the Pell Grant program has sufficient resources, while still safeguarding aid available to the neediest college students. While this Budget provides for significant contributions toward addressing future Pell funding needs, the Administration will work with Congress to ensure the long-term stability of this vital program.

However, we must know that these dollars are spent wisely, and that existing Pell recipients – which comprise approximately 41 percent of the undergraduate population – are being sufficiently supported by their institutions into reaching positive outcomes such as on-time graduation. To that end, the College Opportunity and Graduation Bonuses program would provide funds for a new grant program that will reward colleges that successfully enroll and graduate a significant number of low- and moderate-income students on time and encourage all institutions to improve their performance. The grants made through this program would be used for making key investments and adopting best practices that will further increase college access and success for low-income students, such as by awarding additional need-based financial aid, enhancing academic and student support services, improving student learning and other outcomes while reducing costs, using technology to scale and enhance improvements, establishing or expanding accelerated learning opportunities, as well as other innovations, interventions, and reforms.

## QUESTIONS SUBMITTED BY SENATOR JEFF SESSIONS

### D.C. OPPORTUNITY SCHOLARSHIP PROGRAM

*Question.* The Obama Administration has said that it will use only one test when deciding what programs to fund: "It's not whether a program is liberal or conservative, but whether it works."

Given the Administration's stated position to fund "what works," what evidence can you cite given the continual pushes to de-fund the D.C. Opportunity Scholarship Program (D.C. OSP), shown by the Department of Education's own empirical analysis to achieve statistically significant increases in graduation rates for children?

Answer. The previous evaluation of the DC Opportunity Scholarship Program (OSP) did not find that the OSP affected student achievement, and found statistically significant positive impacts on high school graduation only for some subgroups of students. The Administration believes that we need to focus our time and resources on reforming the public school system to benefit all students. The Administration is committed to providing scholarships through 12th grade for students currently enrolled in the program. The Fiscal Year 2015 Budget includes funding for the evaluation of the program and grantee administration, but it does not include funding for scholarships because the grantee has a balance sufficient to continue scholarships through school year 2015-16 for students currently in the program.

### STUDENT LOAN DEFAULT RATES

*Question.* Secretary Duncan, the rising costs of higher education and how future students affect our economy while being saddled with debt is a growing concern. For decades colleges have effectively been guaranteed an income stream and the ability of colleges to raise costs has been facilitated by a sharp increase in Federal student aid.

Please provide additional information along with any internal and independent reviews concerning what the Department is doing to address this growing trend including what future default rates are projected to be and how much this is projected to increase all over the next 10 years.

Answer. The Administration's landmark investments in Pell Grants, coupled with the creation of more generous tax credits and loan repayment options, have helped more Americans access a college education and helped slow increases in the net price that students and families pay for college. The number of students able to afford college with Pell Grants has grown by 50 percent, to nearly 9 million, and the President's Pay as You Earn (PAYE) plan expanded income-based college loan repayment to an additional

1.6 million students. Established in 2009, the American Opportunity Tax Credit provides up to $10,000 for 4 years of college tuition for families earning up to $180,000. The Administration worked with Republicans and Democrats in Congress to keep interest rates low on student loans now and in the future. Families also have access to better information today; since the launch of the Financial Aid Shopping Sheet, 2,000 institutions—enrolling almost half of all college students nationwide—have adopted this tool, which helps students compare various aid packages and understand the aid for which they qualify. In 2013, the Administration also launched the College Scorecard, which provides critical information on nearly 4,000 colleges and universities. In addition, the Administration has dramatically simplified the Free Application for Federal Student Aid (FAFSA). And, the Federal Income-Based Repayment and PAYE repayment plans are helping student borrowers to manage their debt, especially in the early years of repayment.

But we cannot expect Federal student aid to keep pace with rising college costs indefinitely. Instead, we need systemic State and institutional reforms as well, that address the root causes affecting college affordability, while also creating incentives to provide greater quality at a lower cost to students—a task the Federal Government cannot take on alone. In August, the President outlined an ambitious new agenda to combat rising college costs and make college affordable for American families. His plan will measure college performance through a new ratings system so students and families have the information to select schools that provide the best value and encourage all colleges to improve, shine a light on the most cutting-edge college practices for providing high value at low costs, and help borrowers who are struggling with their student loan debt. Building on this agenda, the Fiscal Year 2015 President's Budget outlines a plan for States, colleges, families and the Federal Government to share in the responsibility of improving higher education access, affordability, and student outcomes. It would increase the Federal investment in postsecondary education—while also challenging and helping States, colleges and families to work together to slow the growth in tuition and fees.

In terms of the relationship between Federal student aid and tuition, GAO found that it is difficult to determine if there is a direct link between, for instance, access to higher amounts of Stafford loans and the increases in college prices (http://www.gao.gov/assets/670/660991.pdf). In addition, they also found that after the Stafford loan limit increase began in academic year 2007-08, "the price and the numbers of undergraduate students enrolling in the nation's institutions of higher education increased at a rate generally consistent with prior years" (http://www.gao.gov/assets/100/97510.pdf). These students also borrowed the maximum loan amounts available to them in lower numbers than did students attending in academic year 2003-04.

Below is a table showing the estimated lifetime default rates for Direct Loans for fiscal years 2013-2024.

**Estimated Direct Loan Lifetime Default Rates (%) - Fiscal Years 2013-2024**

| | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** |
|---|---|---|---|---|---|---|
| Stafford (Subsidized) Loans | 20.08% | 19.72% | 19.41% | 19.35% | 19.33% | 19.34% |
| Unsubsidized Loans: | | | | | | |
| Undergraduate | 20.42% | 20.04% | 19.68% | 19.61% | 19.62% | 19.64% |
| Graduate/Professional | 5.55% | 5.47% | 5.39% | 5.37% | 5.35% | 5.34% |
| PLUS Loans: | | | | | | |
| Parent PLUS | 7.71% | 7.46% | 7.31% | 7.23% | 7.16% | 7.12% |
| Grad PLUS | 6.03% | 5.93% | 5.87% | 5.84% | 5.82% | 5.81% |
| Consolidation Loans | 21.87% | 22.13% | 21.24% | 20.88% | 20.67% | 20.62% |
| **Total Weighted Average, FYs 2013-2018** | **15.85%** | **15.50%** | **15.08%** | **14.90%** | **14.77%** | **14.68%** |

| | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** |
|---|---|---|---|---|---|---|
| Stafford (Subsidized) Loans | 19.35% | 19.66% | 19.68% | 19.69% | 19.71% | 19.74% |
| Unsubsidized Loans: | | | | | | |
| Undergraduate | 19.65% | 20.03% | 20.04% | 20.04% | 20.04% | 20.04% |
| Graduate/Professional | 5.33% | 5.30% | 5.29% | 5.27% | 5.26% | 5.25% |
| PLUS Loans: | | | | | | |
| Parent PLUS | 7.09% | 7.06% | 7.02% | 6.99% | 6.96% | 6.92% |
| Grad PLUS | 5.80% | 5.76% | 5.75% | 5.74% | 5.72% | 5.71% |
| Consolidation Loans | 20.60% | 20.57% | 20.50% | 20.45% | 20.38% | 20.62% |
| **Total Weighted Average, FYs 2019-2024** | **14.59%** | **14.64%** | **14.55%** | **14.46%** | **14.36%** | **14.34%** |

As the table shows, future lifetime default rates are estimated to remain relatively flat -- and, on the whole, decrease -- for all student loan types over the 10-year budget window.

## OUTSTANDING STUDENT LOAN DEBT

*Question.* The Federal Reserve's Consumer Financial Protection Bureau (CFPB) in July 2013 estimated that outstanding student loan debt was approaching $1.2 trillion as of May 2013. This may be a very conservative estimate since the CFPB's methodology does not account for other forms of debt that student loan borrowers have taken on. My concern is that the Department doesn't see the forest from the trees on this issue and is primarily concerned with "tackling college costs," but not in concert with the serious debt ramifications they bring as well.

Please provide additional information along with any internal and independent reviews concerning information on the size of the total outstanding loans, how fast it is growing including projected default rates, what possible dangers there are in this portfolio that you hold, and what are the prospects for repayment all over the next 10 years.

Answer. The rise in college costs is a very significant issue to this Administration, as it negatively impacts many Americans, and can put higher education out of reach for many people. The growth in published tuition and fees in higher education far outpaces cost increases other industries: in academic year 2013-14, the inflation-adjusted cost at a public 4-year institution is 3.3 times as high as it was in 1983-

84; at a public 2-year institutions it is 2.6 times as high; and at a private nonprofit 4-year institution it is 2.5 times as high (College Board, 2013). The average tuition at a public 4-year college has increased by more than 250 percent over the past 3 decades, while incomes for typical families grew by only 16 percent, according to College Board and Census data. Declining State funding has forced students to shoulder a bigger proportion of college costs; tuition has almost doubled as a share of public college revenues over the past 25 years from 25 percent to 47 percent.

To date, the Administration has taken several steps to address this issue, including historic investments in college affordability, increasing the maximum Pell Grant award for working and middle class families by almost $1000, creating the American Opportunity Tax Credit, and enacting effective student loan reforms that eliminate bank subsidies and make college more affordable. Specifically:

- To help millions more families afford college, the Administration has expanded income-based repayment to help borrowers manage their student loan payments. A simplified Free Application for Federal Student Aid (FAFSA) and Financial Aid Shopping Sheet have made it easier for students to apply for and compare aid packages.
- To keep costs down and increase access and success for the Nation's most vulnerable learners, the Administration is working with colleges, nonprofits, and business and philanthropy leaders to develop innovations that improve affordability and completion.
- To provide the public with good information, the U.S. Department of Education is working to put more tools in people's hands, such as the College Scorecard. One crucial step is developing a new ratings system that will measure college performance so that students and families can select schools that provide the best value.

A snapshot of outstanding Federal student loan balances from 2007 through the second quarter of fiscal year 2014 follows:

**Federal Student Aid Portfolio Summary**

*Includes outstanding principal and interest balances;* Data Source: National Student Loan Data System (NSLDS)

| | | Direct Loans | | Federal Family Education Loans (FFEL) | | Perkins Loans | | Total[1] | |
|---|---|---|---|---|---|---|---|---|---|
| Federal Fiscal Year[2] | | Dollars Outstanding (in billions) | Recipients[3] (in millions) | Dollars Outstanding (in billions) | Recipients (in millions) | Dollars Outstanding (in billions) | Recipients (in millions) | Dollars Outstanding (in billions) | Unduplicated Recipients (in millions) |
| 2007 | | $106.8 | 7.0 | $401.9 | 22.6 | $8.2 | 2.8 | $516.0 | 28.3 |
| 2008 | | $122.5 | 7.7 | $446.5 | 23.7 | $8.5 | 2.9 | $577.0 | 29.9 |
| 2009 | | $154.9 | 9.2 | $493.3 | 25.0 | $8.7 | 3.0 | $657.0 | 32.1 |
| 2010 | | $224.5 | 14.4 | $516.7 | 25.1 | $8.4 | 2.9 | $749.8 | 34.3 |
| 2011 | | $350.1 | 19.4 | $489.8 | 23.8 | $8.3 | 2.9 | $848.2 | 36.5 |
| 2012 | | $488.3 | 22.8 | $451.7 | 22.4 | $8.2 | 2.9 | $948.2 | 38.3 |
| 2013 | Q1 | $508.7 | 23.4 | $444.9 | 22.1 | $8.2 | 3.0 | $961.9 | 38.7 |
| | Q2 | $553.0 | 24.1 | $437.0 | 21.6 | $8.3 | 3.0 | $998.6 | 38.9 |
| | Q3 | $569.2 | 24.3 | $429.5 | 21.2 | $8.2 | 2.9 | $1,006.8 | 38.7 |
| | Q4 | $609.1 | 25.6 | $423.0 | 20.9 | $8.1 | 2.9 | $1,040.2 | 39.6 |
| 2014 | Q1 | $626.5 | 26.2 | $417.1 | 20.6 | $8.2 | 3.0 | $1,051.8 | 40.0 |
| 2014 | Q2 | $669.0 | 26.5 | $409.7 | 20.2 | $8.3 | 3.0 | $1,087.0 | 40.0 |

[1] Totals may not equal the sum of Direct Loans, FFEL, and Perkins Loans due to rounding and the timing of the data runs.

[2] Data is run at the end of the corresponding Federal fiscal year or at the end of each quarter listed by federal fiscal year. Each Federal fiscal year begins October 1 and ends September 30. Q1 ends 12/31, Q2 ends 3/31, Q3 ends 6/30, and Q4 ends 9/30.

[3] Recipient is the student that benefits from the Federal student loan. In most cases, the recipient is the borrower, but in Parent PLUS loans, the parent is the borrower and their child is the recipient.

While the outstanding portfolio has grown significantly since 2007 (particularly due to the increase in college enrollment), that pace is expected to slow in future years as economic conditions improve. And, it is important to note the increase in outstanding student loans in the context of the lifetime default data, presented in an earlier response: while the portfolio continues to grow, the rate at which borrowers default is expected to decrease slightly.

Additionally, an estimate of the future loan principal outstanding is as follows (Note: this table includes principal balances only, whereas the table referred to in the prior paragraph includes both principal and interest balances):

**Estimated Future Loan Principal Outstanding, By Loan Program, 2015 – 2024**

(Table in Billions of $; $ amounts may not add due to rounding)

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|
| Direct Loans Principal Outstanding | $767.1 | $850.3 | $928.6 | $1,002.7 | $1,073.4 | $1,143.6 | $1,213.1 | $1,283.3 | $1,357.5 | $1,434.4 |
| FFEL Loans Principal Outstanding | 235.0 | 207.0 | 183.6 | 164.4 | 148.6 | 135.1 | 123.5 | 113.7 | 107.3 | 103.0 |
| **Total** | **1,002.0** | **1,057.4** | **1,112.2** | **1,167.1** | **1,222.0** | **1,278.8** | **1,336.6** | **1,396.9** | **1,464.8** | **1,537.5** |

The chart below outlines the Department's estimated loan collections from non-Federal sources over the period 2014-2024. For each loan program, the term "total non-Federal collections" means:

- Direct Loans - primarily borrower repayments, default recoveries, and fees;
- FFEL default recoveries, fees, and negative special allowance payments; and,
- FFEL Liquidating account default collections.

**Department's Estimated Loan Collections from Non-Federal Sources, 2014 – 2024**

(Table in Billions of $; $ amounts may not add due to rounding)

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Non-Federal Collections | | | | | | | | | | | |
| Direct Loan Program | $50.9 | $63.6 | $78.1 | $93.4 | $108.2 | $122.3 | $134.6 | $147.7 | $159.6 | $169.5 | $181.3 |
| FFEL Program | 14.5 | 14.0 | 12.0 | 9.9 | 8.4 | 7.5 | 6.8 | 6.0 | 5.1 | 4.2 | 3.4 |
| FFEL Liquidating Account | .3 | .3 | .2 | .2 | .2 | .1 | .1 | .1 | .1 | .1 | .1 |
| **Total** | **65.7** | **77.9** | **90.3** | **103.4** | **116.8** | **130.0** | **141.5** | **153.8** | **164.8** | **173.7** | **184.8** |

While the outstanding portfolio has grown significantly since 2007 (particularly due to the increase in college enrollment), that pace is expected to slow in future years as economic conditions improve. And, it is important to note the increase in outstanding student loans in the context of the lifetime default data presented in an earlier response: while the portfolio continues to grow, the rate at which borrowers default is expected to decrease slightly.

# THE U.S. ECONOMIC AND FISCAL OUTLOOK

**THURSDAY, MAY 8, 2014**

UNITED STATES SENATE,
COMMITTEE ON THE BUDGET,
*Washington, D.C.*

The Committee met, pursuant to notice, at 9:30 a.m., in Room SD–608, Dirksen Senate Office Building, Hon. Patty Murray, Chairman of the Committee, presiding.

Present: Senators Murray, Nelson, Stabenow, Whitehouse, Merkley, Coons, Kaine, King, Sessions, Grassley, Graham, Portman, Johnson, Ayotte, and Wicker.

Staff Present: Evan T. Schatz, Majority Staff Director; and Eric M. Ueland, Minority Staff Director.

## OPENING STATEMENT OF CHAIRMAN MURRAY

Chairman MURRAY. This hearing will come to order. Thank you to my Ranking Member, Senator Sessions, and all of our colleagues who are here and many who will be joining us.

Today we have the great opportunity to hear from the Chair of the Federal Reserve, Dr. Janet Yellen. Dr. Yellen, I want to start by thanking you for your leadership in encouraging stronger economic growth, stability, and job creation throughout your tenure at the Federal Reserve as Vice Chair and now as Chair. It really is wonderful to have you here.

I also do want to take a moment and recognize your predecessor, Chairman Ben Bernanke, for all the work he did on behalf of the country through some extraordinarily difficult times.

I am glad that we do have the opportunity today to talk about our economic and our fiscal outlook and the steps we can take to continue creating jobs and broad-based growth now and over the long term.

Dr. Yellen, your new role at the Fed comes at a very dynamic time. Just a few years ago, the economy faced its biggest crisis since the Great Depression. We were hemorrhaging jobs, business faced a massive liquidity crisis, and markets were in a free fall. I think we all remember how grave the situation was and how much fear and uncertainty there was throughout the country.

As all of this unfolded, the Fed stepped in. They acted boldly and aggressively. They cut interest rates, launched new emergency programs, and played a very key role in coordinating the crisis response. Thanks in no small part to the decisive work of the Federal Reserve, our economy is much stronger than it was 5 years ago when the Great Recession hit. More workers are getting back on the job. The unemployment rate has declined to 6.3 percent, the lowest level since September of 2008.

But as you have noted before, Dr. Yellen, the unemployment rate is only part of the story. Across the country there are still far too many men and women who simply gave up hope finding a job and dropped out of the labor force. There are millions of workers who would like to take on more hours but are stuck in part-time jobs that leave them really struggling to get by.

Millions more have been hoping for a much deserved raise for years, and they are still waiting. And as a result of decades of rising prices and stagnant or declining wages, families are now finding it more and more difficult to buy a home, send their children to school, and save for retirement, the opportunities that I know everyone in this room wants them to have.

So while we have made some real progress, there is still a lot we need to do to not only get Americans back to work, but to encourage the kind of economic growth that leads to higher-wage jobs, more opportunity, and a stronger middle class.

Taking a responsible approach to our budget challenges will be a critical part of this effort. Since August of 2010, Congress has put in place roughly $3.3 trillion in deficit reduction over the 10-year window. Some of that deficit reduction came from letting the Bush tax cuts expire for those at the top of the income spectrum. But the majority came from deep spending cuts as a result of fiscally austere policies fought for by many of my Republican colleagues. That includes the across-the-board cuts from sequestration which impacted so many of our families and communities across the country.

Today our near-term budget outlook has improved significantly. We have stabilized the deficit as a share of the economy for the next several years. And the deficit for this fiscal year is expected to be about a third lower than what the Congressional Budget Office projected it would be 5 years ago. It is important to keep in mind, however, that as many economists and experts have noted, fiscal austerity, like the steep spending cuts from sequestration, has actually hurt our recovery, slowed growth, and cost jobs.

These cuts also crippled critical Federal investments that make our workforce more competitive and expand economic growth in the long term. And while the cuts did contribute to an improved fiscal outlook in the next few years, they did very little to tackle the real drivers of our debt in coming decades.

Over the last few years, the conversation about these two challenges—boosting our economy, getting our fiscal house in order—took place within a cycle of lurching from crisis to crisis on our budget. Those crises created a lot of economic uncertainty and put the focus on getting through the next crisis rather than reach an agreement on measures to help the economy recover in the near term and tackle our debt in the long term.

With the 2-year budget agreement that Chairman Ryan and I reached in place, we finally have a chance to look at these challenges without one budget deadline after another hanging over us. I am very hopeful we can take advantage of this opportunity and be able to build on the Bipartisan Budget Act by working together on a balanced approach that puts job creation and growth first and continues to address our debt and deficit.

This means even as we look for ways to tackle our long-term budget challenges, we need to address the other deficits that we face in areas like education and innovation and infrastructure and research, which are very critical to job creation and broad-based economic growth now and over the long term.

It means we will need to follow the recommendation of the bipartisan experts and include both responsible spending cuts and new revenue from those who can afford it most in our deficit reduction efforts.

And as we have seen in the last few years, we will need to protect our economy by phasing in deficit reduction over time rather than allowing deep, immediate spending cuts like those in sequestration to slow growth and hurt our recovery.

I strongly believe that if we can take this kind of balanced approach, our economic growth will be stronger and more broadly felt right now for the millions of workers and families still struggling and for workers and families in the decades to come.

All of this will be especially important as the Federal Reserve begins to scale back its most recent round of quantitative easing. For most of the last 3 years, the Federal Reserve has had to step up its efforts because of the counterproductive austerity measures pursued by some in Congress. But in this more stable budget environment, I hope Congress will be able to work together to encourage job creation and growth in a bipartisan way.

I know there are serious differences between our two parties when it comes to the best ways to encourage growth and fiscal responsibility. But really our work on the Bipartisan Budget Act has shown that when Democrats and Republicans come to the table ready to make tough choices and compromise, we can find agreement and take some sensible steps towards addressing the Nation's near-and long-term economic and fiscal challenges. That is what the American people expect of us.

So I am very hopeful we will be able to continue to make progress. Dr. Yellen, thank you again for the critical work you are doing and for taking the time to be with us at this Committee today.

With that, I will turn it over to my colleague, Senator Sessions.

## OPENING STATEMENT OF SENATOR SESSIONS

Senator SESSIONS. Thank you. Thank you, Chairman Murray, for your courtesy. Thank you, Chairman Yellen, for appearing before us today for an important discussion, and I know you had one yesterday.

I must say that I do not think we can say our economy is where we want it to be. It has some very serious problems.

Like the foundation of a home, America's economy must be built on something real, solid, and something firmly planted. Neither Federal stimulus in the form of easy money nor fiscal stimulus in the form of Government borrowing can produce real lasting prosperity or a sound financial future long term.

Millions of Americans face the economic future with great unease today. A large majority think the Nation is on the wrong track. No

Government regulator, you or your predecessors, no matter how intelligent, can see into the future and micromanage the economy.

Let us consider the testimony of former Chairman Alan Greenspan at that table before this Committee in January of 2001. Chairman Greenspan came to alert Congress about an urgent policy decision that we would have to make. And what was that decision? Whether to raise the interest rates, reduce subprime lending, reform entitlements? No. Chairman Greenspan came to warn us that we would have to decide how to spend all of the surplus money after we soon paid off the entire Federal debt of the United States of America.

He predicted budget surpluses "well past 2030, despite the budgetary pressures from the aging baby-boom generation." And he said that, "The highly desirable goal of paying off the Federal debt is in reach before the end of the decade."

Greenspan warned that after "continuing to run surpluses beyond the point at which we reach zero or near zero Federal debt," we would need to eschew private asset accumulation. He added for emphasis that, "The emerging key fiscal policy need is to address the implications of maintaining surpluses beyond the point at which publicly held debt was effectively eliminated."

So forgive us if we cannot—we as policy leaders ought not to assume everything you tell us is always correct. The maestro was certainly wrong in that.

The Federal Reserve is not infallible. Our responsibility as legislators is to provide oversight. We are one small voice for the American people in watching the organization that you head.

In 2011, the Fed forecasted growth last year between 3.5 and 4.3 percent. Actual growth was an anemic 1.9 percent, roughly half of what you predicted. This is a drastic overestimation, not a small miss. And the Fed overestimated 2013 growth in every formal quarterly prediction for each year since 2011. For the people's representatives, your performance in that regard, the Fed's performance before you became Chairman, is not good.

Let us consider whether the stimulus policies of the last 5 years have produced the results predicted. Since 2007, interest rates have been near zero, and the Federal Government has added $8.3 trillion to the debt. But where do we stand? The population has grown by 15 million since 2007, yet we are still 500,000 fewer people working today than in 2007.

The workforce participation rate has fallen to 63 percent of the civilian population, which is the lowest level in 36 years. Median household income has fallen an average of $2,268 per household. That is huge for working Americans, almost $200 a month less median household income. And the low-income cohort has grown while the middle-income group has shrunk. The middle class is getting smaller in America.

While the stimulus mind-set in Washington has at least so far been better for the investor class and the political class, it has not been good for the working class. Not only has the stimulus failed American workers, but it has left us with regard debt and an economy dependent on unprecedented policies that you and I know cannot continue.

One of your two statutory duties is to advance full employment. While the good job numbers last month are a positive sign, it was fully offset, it seems to me, by the fact that 988,000 people dropped out of the labor market entirely, and the large numbers that did get jobs were part-time jobs.

So the time has come, I think, to assume and return to first principles. Spend what you have. Plan for the future carefully. Lay out policies that are prudent and can be maintained long term. Do not borrow what you cannot pay back.

So here are some ways I think would improve the economy without adding to the surplus, without adding to the debt, and I think each and every one of these absolutely would help create jobs and prosperity: more American energy; eliminate all costly and wasteful regulations that do not provide benefit; make the Tax Code flatter, simpler, revenue neutral; help our companies be globally competitive; ensure that fair trade protects our workers from unfair trade; adopt an immigration policy that serves American workers; turn the welfare office into a job training center; streamline the Government, make it more productive; and balance the Federal budget to restore economic confidence. These are concrete steps that will work. We need to return to those principles and move this country forward, and I look forward to discussing with you any other ideas you might have that would help the country prosper.

Chairman MURRAY. Thank you very much, Senator Sessions.

With that, we are very delighted to have the Chairman of the Federal Reserve with us today. Dr. Yellen, we will turn it over to you for your testimony.

**STATEMENT OF THE HONORABLE JANET L. YELLEN, CHAIR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

Ms. YELLEN. Thank you. Chairman Murray, Ranking Member Sessions, and other members of the Committee, I appreciate the opportunity to discuss the current economic situation and outlook along with monetary policy before turning to some issues regarding financial stability.

The economy has continued to recover from the steep recession of 2008 and 2009. Real gross domestic product growth stepped up to an average annual rate of about 3–1/4 percent over the second half of last year, a faster pace than in the first half and during the preceding 2 years. Although real GDP growth is currently estimated to have paused in the first quarter of this year, I see that pause as mostly reflecting transitory factors, including the effects of the unusually cold and snowy winter weather. With the harsh winter behind us, many recent indicators suggest that a rebound in spending and production is already under way, putting the overall economy on track for solid growth in the current quarter. One cautionary note, though, is that readings on housing activity—a sector that has been recovering since 2011—have remained disappointing so far this year and will bear watching.

Conditions in the labor market have continued to improve. The unemployment rate was 6.3 percent in April, about 1–1/4 percentage points below where it was a year ago. Moreover, gains in payroll employment averaged nearly 200,000 jobs per month over the past year. During the economic recovery so far, payroll employment has increased by about 8–1/2 million jobs since its low point, and the unemployment rate has declined about 3–3/4 percentage points since its peak.

While conditions in the labor market have improved appreciably, they are still far from satisfactory. Even with recent declines in the unemployment rate, it continues to be elevated. Moreover, both the share of the labor force that has been unemployed for more than 6 months and the number of individuals who work part time but would prefer a full-time job are at historically high levels. In addition, most measures of labor compensation have been rising slowly—another signal that a substantial amount of slack remains in the labor market.

Inflation has been quite low even as the economy has continued to expand. Some of the factors contributing to the softness in inflation over the past year, such as the declines seen in non-oil import prices, will probably be transitory. Importantly, measures of longer-run inflation expectations have remained stable. That said, the Federal Open Market Committee recognizes that inflation persistently below 2 percent—the rate that the Committee judges to be most consistent with its dual mandate—could pose risks to economic performance, and we are monitoring inflation developments closely.

Looking ahead, I expect that economic activity will expand at a somewhat faster pace this year than it did last year, that the unemployment rate will continue to decline gradually, and that inflation will begin to move up toward 2 percent. A faster rate of economic growth this year should be supported by reduced restraint from changes in fiscal policy, gains in household net worth from increases in home prices and equity values, a firming in foreign economic growth, and further improvements in household and business confidence as the economy continues to strengthen. Moreover, U.S. financial conditions remain supportive of growth in economic activity and employment.

As always, considerable uncertainty surrounds this baseline economic outlook. At present, one prominent risk is that adverse developments abroad, such as heightened geopolitical tensions or an intensification of financial stresses in emerging market economies, could undermine confidence in the global economic recovery. Another risk—domestic in origin—is that the recent flattening out in housing activity could prove more protracted than currently expected rather than resuming its earlier pace of recovery. Both of these elements of uncertainty will bear close observation.

Turning to monetary policy, the Federal Reserve remains committed to policies designed to restore labor market conditions and inflation to levels that the Committee judges to be consistent with its dual mandate. As always, our policy will continue to be guided by the evolving economic and financial situation, and we will adjust the stance of policy appropriately to take account of changes in the economic outlook. In light of the considerable degree of slack that remains in labor markets and the continuation of inflation below the Committee's 2-percent objective, a high degree of monetary accommodation remains warranted.

With the Federal funds rate, our traditional policy tool, near zero since late 2008, we have relied on two less conventional tools to provide support for the economy: asset purchases and forward guidance. And because these policy tools are less familiar, we have been especially attentive in recent years to the need to communicate to the public about how we intend to employ our policy tools in response to changing economic circumstances.

Our current program of asset purchases began in September 2012 when the economic recovery had weakened and progress in the labor market had slowed, and we said that our intention was to continue the program until we saw substantial improvement in the outlook for the labor market. By December 2013, the Committee judged that the cumulative progress in the labor market warranted a modest reduction in the pace of asset purchases. At the first three meetings this year, our assessment was that there was sufficient underlying strength in the broader economy to support ongoing improvement in labor market conditions, so further measured reductions in asset purchases were appropriate. I should stress that even as the Committee reduces the pace of its purchases of longer-term securities, it is still adding to its holdings, and those sizable holdings continue to put significant downward pressure on longer-term interest rates, support mortgage markets, and contribute to favorable conditions in broader financial markets.

Our other important policy tool in recent years has been forward guidance about the likely path of the Federal funds rate as the economic recovery proceeds. Beginning in December 2012, the Committee provided threshold-based guidance that turned importantly on the behavior of the unemployment rate. As you know, at our March 2014 meeting, with the unemployment rate nearing the threshold that had been laid out earlier, we undertook a significant review of our forward guidance. While indicating that the new guidance did not represent a shift in the FOMC's policy intentions, the Committee laid out a fuller description of the framework that will guide its policy decisions going forward. Specifically, the new language explains that, as the economy expands further, the Committee will continue to assess both the realized and expected progress toward its objectives of maximum employment and 2 percent inflation. In assessing that progress, we will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. In March and again last month, we stated that we anticipated the current target range for the Federal funds rate would be maintained for a considerable time after the asset purchase program ends, especially if inflation continues to run below 2 percent, and provided that inflation expectations remain well anchored. The new language also includes information on our thinking about the likely path of the policy rate after the Committee decides to begin to remove policy accommodation. In particular, we anticipate that even after employment and inflation are near mandate-consistent levels, economic and financial conditions may, for some time, warrant keeping the target Federal funds rate below levels that the Committee views as normal in the longer run.

Because the evolution of the economy is uncertain, policymakers need to carefully watch for signs that it is diverging from the baseline outlook and respond in a systematic way to stabilize the economy. Accordingly, for both our purchases and our forward guidance, we have tried to communicate as clearly as possible how changes in the economic outlook will affect our policy stance. In doing so, we will help the public to better understand how the Committee will respond to unanticipated developments, thereby reducing uncertainty about the course of unemployment and inflation.

In addition to our monetary policy responsibilities, the Federal Reserve works to promote financial stability, focusing on identifying and monitoring vulnerabilities in the financial system and taking actions to reduce them. In this regard, the Committee recognizes that an extended period of low interest rates has the potential to induce investors to "reach for yield" by taking on increased leverage, duration risk, or credit risk. Some reach-for-yield behavior may be evident, for example, in the lower-rated corporate debt markets, where issuance of syndicated leveraged loans and high-yield bonds has continued to expand briskly, spreads have continued to narrow, and underwriting standards have loosened further. While some financial intermediaries have increased their exposure to duration and credit risk recently, these increases appear modest to date—particularly at the largest banks and life insurers.

More generally, valuations for the equity market as a whole and other broad categories of assets, such as residential real estate, remain within historical norms. In addition, bank holding companies have improved their liquidity positions and raised capital ratios to levels significantly higher than prior to the financial crisis. Moreover, recently concluded stress tests mandated by the Dodd-Frank Act have provided a level of confidence in our assessment of how financial institutions would fare in an extended period of severely adverse macroeconomic conditions or a sharp steepening of the yield curve alongside a moderate recession. For the financial sector more broadly, leverage remains subdued and measures of wholesale short-term funding continue to be far below levels seen before the financial crisis.

The Federal Reserve has also taken a number of regulatory steps—many in conjunction with other Federal agencies—to continue to improve the resiliency of the financial system. Most recently, the Federal Reserve finalized a rule implementing section 165 of the Dodd-Frank Act to establish enhanced prudential standards for large banking firms in the form of risk-based and leverage capital, liquidity, and risk management requirements. In addition, the rule requires large foreign banking organizations to form a U.S. intermediate holding company, and it imposes enhanced prudential requirements for these intermediate holding companies. Looking forward, the Federal Reserve is considering whether additional measures are needed to further reduce the risks associated with large, interconnected financial institutions.

While we have seen substantial improvements in labor market conditions and the overall economy since the financial crisis and severe recession, we recognize that more must be accomplished. Many Americans who want a job are still unemployed, inflation continues to run below the FOMC's longer-run objective, and work remains to further strengthen our financial system. I will continue to work closely with my colleagues and others to carry out the important mission that Congress has given the Federal Reserve.

Thank you. I will be pleased to take your questions.
[The prepared statement of Ms. Yellen follows:]

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Statement by

Janet L. Yellen

Chair

Board of Governors of the Federal Reserve System

before the

Committee on the Budget

U.S. Senate

May 8, 2014

Chairman Murray, Ranking Member Sessions, and other members of the Committee, I appreciate this opportunity to discuss the current economic situation and outlook along with monetary policy before turning to some issues regarding financial stability.

**Current Economic Situation and Outlook**

The economy has continued to recover from the steep recession of 2008 and 2009. Real gross domestic product (GDP) growth stepped up to an average annual rate of about 3-1/4 percent over the second half of last year, a faster pace than in the first half and during the preceding two years. Although real GDP growth is currently estimated to have paused in the first quarter of this year, I see that pause as mostly reflecting transitory factors, including the effects of the unusually cold and snowy winter weather. With the harsh winter behind us, many recent indicators suggest that a rebound in spending and production is already under way, putting the overall economy on track for solid growth in the current quarter. One cautionary note, though, is that readings on housing activity--a sector that has been recovering since 2011--have remained disappointing so far this year and will bear watching.

Conditions in the labor market have continued to improve. The unemployment rate was 6.3 percent in April, about 1-1/4 percentage points below where it was a year ago. Moreover, gains in payroll employment averaged nearly 200,000 jobs per month over the past year. During the economic recovery so far, payroll employment has increased by about 8-1/2 million jobs since its low point, and the unemployment rate has declined about 3-3/4 percentage points since its peak.

While conditions in the labor market have improved appreciably, they are still far from satisfactory. Even with recent declines in the unemployment rate, it continues to be elevated. Moreover, both the share of the labor force that has been unemployed for more than six months and the number of individuals who work part time but would prefer a full-time job are at historically high levels. In addition, most measures of labor compensation have been rising slowly--another signal that a substantial amount of slack remains in the labor market.

Inflation has been quite low even as the economy has continued to expand. Some of the factors contributing to the softness in inflation over the past year, such as the declines seen in non-oil import prices, will probably be transitory. Importantly, measures of longer-run inflation expectations have remained stable. That said, the Federal Open Market Committee (FOMC) recognizes that inflation persistently below 2 percent--the rate that the Committee judges to be most consistent with its dual mandate--could pose risks to economic performance, and we are monitoring inflation developments closely.

Looking ahead, I expect that economic activity will expand at a somewhat faster pace this year than it did last year, that the unemployment rate will continue to decline gradually, and that inflation will begin to move up toward 2 percent. A faster rate of economic growth this year should be supported by reduced restraint from changes in fiscal policy, gains in household net worth from increases in home prices and equity values, a firming in foreign economic growth, and further improvements in household and business confidence as the economy continues to strengthen. Moreover, U.S. financial conditions remain supportive of growth in economic activity and employment.

As always, considerable uncertainty surrounds this baseline economic outlook. At present, one prominent risk is that adverse developments abroad, such as heightened geopolitical tensions or an intensification of financial stresses in emerging market economies, could undermine confidence in the global economic recovery. Another risk--domestic in origin--is that the recent flattening out in housing activity could prove more protracted than currently expected rather than resuming its earlier pace of recovery. Both of these elements of uncertainty will bear close observation.

**Monetary Policy**

Turning to monetary policy, the Federal Reserve remains committed to policies designed to restore labor market conditions and inflation to levels that the Committee judges to be consistent with its dual mandate. As always, our policy will continue to be guided by the evolving economic and financial situation, and we will adjust the stance of policy appropriately to take account of changes in the economic outlook. In light of the considerable degree of slack that remains in labor markets and the continuation of inflation below the Committee's 2 percent objective, a high degree of monetary accommodation remains warranted.

With the federal funds rate, our traditional policy tool, near zero since late 2008, we have relied on two less conventional tools to provide support for the economy: asset purchases and forward guidance. And, because these policy tools are less familiar, we have been especially attentive in recent years to the need to communicate to the public about how we intend to employ our policy tools in response to changing economic circumstances.

Our current program of asset purchases began in September 2012 when the economic recovery had weakened and progress in the labor market had slowed, and we said that our intention was to continue the program until we saw substantial improvement in the outlook for the labor market. By December 2013, the Committee judged that the cumulative progress in the labor market warranted a modest reduction in the pace of asset purchases. At the first three meetings this year, our assessment was that there was sufficient underlying strength in the broader economy to support ongoing improvement in labor market conditions, so further measured reductions in asset purchases were appropriate. I should stress that even as the Committee reduces the pace of its purchases of longer-term securities, it is still adding to its holdings, and those sizable holdings continue to put significant downward pressure on longer-term interest rates, support mortgage markets, and contribute to favorable conditions in broader financial markets.

Our other important policy tool in recent years has been forward guidance about the likely path of the federal funds rate as the economic recovery proceeds. Beginning in December 2012, the Committee provided threshold-based guidance that turned importantly on the behavior of the unemployment rate. As you know, at our March 2014 meeting, with the unemployment rate nearing the threshold that had been laid out earlier, we undertook a significant review of our forward guidance. While indicating that the new guidance did not represent a shift in the FOMC's policy intentions, the Committee laid out a fuller description of the framework that will guide its policy decisions going forward. Specifically, the new language explains that, as the economy expands further, the Committee will continue to assess both the realized and expected progress toward its objectives of maximum employment and 2 percent inflation. In assessing that progress, we will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. In March and again last month, we stated that we anticipated the current target range for the federal funds rate would be maintained for a considerable time after the asset purchase program ends, especially if inflation continues to run below 2 percent, and provided that inflation expectations remain well anchored. The new language also includes information on our thinking about the likely path of the policy rate after the Committee decides to begin to remove policy accommodation. In particular, we anticipate that even after employment and inflation are near mandate-consistent levels, economic and financial conditions may, for some time, warrant keeping the target federal funds rate below levels that the Committee views as normal in the longer run.

Because the evolution of the economy is uncertain, policymakers need to carefully watch for signs that it is diverging from the baseline outlook and respond in a systematic way to stabilize the economy. Accordingly, for both our purchases and our forward guidance, we have tried to communicate as clearly as possible how changes in the economic outlook will affect our policy stance. In doing so, we will help the public to better understand how the Committee will respond to unanticipated developments, thereby reducing uncertainty about the course of unemployment and inflation.

**Financial Stability**

In addition to our monetary policy responsibilities, the Federal Reserve works to promote financial stability, focusing on identifying and monitoring vulnerabilities in the financial system and taking actions to reduce them. In this regard, the Committee recognizes that an extended period of low interest rates has the potential to induce investors to "reach for yield" by taking on increased leverage, duration risk, or credit risk. Some reach-for-yield behavior may be evident, for example, in the lower-rated corporate debt markets, where issuance of syndicated leveraged loans and high-yield bonds has continued to expand briskly, spreads have continued to narrow, and underwriting standards have loosened further. While some financial intermediaries have increased their exposure to duration and credit risk recently, these increases appear modest to date--particularly at the largest banks and life insurers.

More generally, valuations for the equity market as a whole and other broad categories of assets, such as residential real estate, remain within historical norms. In addition, bank holding companies (BHCs) have improved their liquidity positions and raised capital ratios to levels significantly higher than prior to the financial crisis. Moreover, recently concluded stress tests mandated by the Dodd-Frank Act have provided a level of confidence in our assessment of how financial institutions would fare in an extended period of severely adverse macroeconomic conditions or a sharp steepening of the yield curve alongside a moderate recession. For the financial sector more broadly, leverage remains subdued and measures of wholesale short-term funding continue to be far below levels seen before the financial crisis.

The Federal Reserve has also taken a number of regulatory steps--many in conjunction with other federal agencies--to continue to improve the resiliency of the financial system. Most recently, the Federal Reserve finalized a rule implementing section 165 of the Dodd-Frank Act to establish enhanced prudential standards for large banking firms in the form of risk-based and leverage capital, liquidity, and risk-management requirements. In addition, the rule requires large foreign banking organizations to form a U.S. intermediate holding company, and it imposes enhanced prudential requirements for these intermediate holding companies. Looking forward, the Federal Reserve is considering whether additional measures are needed to further reduce the risks associated with large, interconnected financial institutions.

While we have seen substantial improvements in labor market conditions and the overall economy since the financial crisis and severe recession, we recognize that more must be accomplished. Many Americans who want a job are still unemployed, inflation continues to run below the FOMC's longer-run objective, and work remains to further strengthen our financial system. I will continue to work closely with my colleagues and others to carry out the important mission that the Congress has given the Federal Reserve.

Thank you. I will be pleased to take your questions.

Chairman MURRAY. Thank you very much for your testimony.

And for our Committee members, we are going to keep our questions to 5 minutes each for this since we have a number of members here and votes that are coming up.

Over the past several years, you, your predecessor, and your many colleagues on the Federal Reserve System worked really tirelessly to put the economy back on track using all the tools of monetary policy at your disposal. I wanted to ask you about the role that fiscal policy played and should play in healing the economy. We have been having a very robust debate here in Congress about the direction of near-term fiscal policy, and some of my colleagues have been urging very large and immediate cuts to a wide swath of public investments, programs, services, and, in fact, Government spending and the overall budget deficit have both shrunk at or near historic rates over the last several years.

I wanted to ask you this morning about the effect of these fiscal policies. Do you think that near-term spending cuts are beneficial for our economy's recovery?

Ms. YELLEN. I think that fiscal policy, while it has accomplished a very meaningful reduction in the budget deficit, as you pointed out, has served as a drag on the economy, on spending and aggregate demand in the economy, and in a sense, this has been part of the headwinds that the Federal Reserve has had to confront in designing our own monetary policy.

My predecessor asked in a sense that fiscal policy should do no harm. We are looking at a significant reduction during this year in the amount of drag we are likely to see from fiscal policy. According to CBO's estimates, last year tightening fiscal policy both on the spending and tax side subtracted about 1–1/2 percentage points from GDP growth, and that drag is projected to diminish to something on the order of half a percent. And so that is really one of the reasons that my colleagues and I are forecasting stronger growth and continued improvement in the labor market.

Now, I do want to agree with my predecessor in emphasizing, though, that long-run sustainability of fiscal policy and the debt is something that is very important. As you mentioned, this is something, a set of changes, further changes, as we look at CBO's longer-term budget projections, we can see that going out 20, 30, 50 years without some further shifts in fiscal policy, it is projected that the ratio of debt to GDP will rise to unsustainable levels. And I would join my predecessor in saying that I do think it is important that the Congress address that issue, that having a long-run sustainable fiscal policy and debt-to-GDP path that can be maintained over time does require changes. But it does not require changes that would come into effect so quickly that it would impede the recovery.

Chairman MURRAY. Do you think the various stand-offs and crises that we have had surrounding the debt limit had negative consequences for our broader economy?

Ms. YELLEN. It is hard to put a number on what the impact of all of those crises has been, but I think probably all of you have had the same experience that I have had as you talk to business people around the country and to households as well, who do talk about uncertainties surrounding fiscal policy and that crisis atmosphere along with other elements of regulation and uncertainty about the outlook as something that has diminished their willingness to hire and invest. And I do think that mentality is beginning to change, and I consider it a good sign for the economy going forward.

Chairman MURRAY. Okay. I only have a few seconds left, but I did want to ask you about the discussion we are having about wealth and income inequality. We have had some hearings on that here. I know you have thought a lot about the role that opportunity plays in growing our economy and talked about the enormous positive impact from opening up more economic opportunities for women. And I just would love to have you comment on that in my last 20 seconds here.

Ms. YELLEN. I am very concerned about rising inequality. It is a long-term trend that I think is very disturbing, and it is something that public policymakers should focus on.

I do think that opportunity for women has been very important, not only recently but really over the last century, increasing opportunities for women and their expanding role in the workforce in promoting a strong economy and really a century of very solid economic performance and growth, and I hope that will continue.

Chairman MURRAY. Thank you very much.

Senator Sessions?

Senator SESSIONS. Thank you.

Dr. Yelllen, we have had unprecedented stimulus in the fiscal side, including $1 trillion almost in one single piece of legislation. We did have a containment of spending last year, but it will begin to go back up again soon. So we are far from austere. And Dr. Elmendorf has told us that whereas the interest on our debt last year was $221 billion, he projects it to be $876 billion in 10 years. So this is a threat to our future, and we simply have to get our fiscal house in order, and I hope you understand that. And you are not going to be able to call over from the Fed and tell Congress now is the time we would like for you to cut spending this month, but not cut it next month.

Now, since 2009, the United States has borrowed $8 trillion and added $8 trillion in new debt. Since 2008, the Federal Reserve has increased its balance sheet debt five-fold from $900 billion to $4 trillion, over $4 trillion. So let me ask you first: Who has benefitted most so far in this process of stimulating the economy: investors, CEOs, or everyday working middle-class Americans?

Ms. YELLEN. So I would say that there have been widespread benefits from the policies that we have followed. Since the low, we have created, the economy has created over 8 million jobs. And monetary policy has sought to foster that and I believe has made some contribution there.

Senator SESSIONS. But could I ask you on the job creation, we talk about jobs created. We created 288,000 last month, which was the best month, supposedly, we have had since—I guess one of the best since the recession. But 988,000 dropped out of the labor market, and we have got fewer people working today than there were in 2007. So how can we tell the American—and the population has increased by 15 million, 8 million in the work age group. So how is this progress, please tell me?

Ms. YELLEN. First of all, I would caution you not to emphasize too much one month's fluctuation, things like that.

Senator SESSIONS. I agree with that.

Ms. YELLEN. I guess if we look over the last 6 months or so, I would describe the labor force participation rate as roughly stable. However, looked at over a longer span, the labor force participation rate has declined very substantially. And I would say that there are two reasons for that. One is demographic, and it is something that we should expect to continue going forward. As I look forward, I am envisioning in coming years a continued secular decline in labor force participation, and that is due to the fact that the baby boomers are entering the retirement years. And as the fraction of the population in the retirement years rises, it is very natural—

Senator SESSIONS. But, Dr. Yellen, the data show, at least this recently, that the over 55 are participating at a higher rate than the under 55. Do you not agree?

Ms. YELLEN. Yes, it—

Senator SESSIONS. One columnist in Barrons said it is because daddy has got to take care of the unemployed son in the basement.

Ms. YELLEN. It is absolutely true what you say, that younger cohorts, more recent retirees, are working more than their predecessors did, and we have seen their rate of labor force participation rise. But in looking at the overall trend, that is dominated by the fact that there is an increasing fraction of the labor force in these retirement years. But I do want to emphasize that there is more that is going on here, at least in my view, than simply demographics, because labor force participation has also declined among prime age workers and among young people, in part because they are in school a lot more.

But I think that some of those declines—and a portion probably of the decline among retirees as well—is because we have a weak labor market, and—

Senator SESSIONS. Well, I think we have a weak, slack labor market. I agree with that. You said yesterday we have never seen a situation where long-term unemployment is so large a fraction of unemployment.

Ms. YELLEN. I agree.

Senator SESSIONS. That is a very significant concern, would you—

Ms. YELLEN. Yes, we are on the order of 35 percent, and that is—of all those unemployed more than 6 months, and that is a very disturbing trend and something that we would like to be able to do something about.

Senator SESSIONS. Well, thank you for your service. You have undertaken a tough job. We want to be positive and helpful, but from the point of view of working Americans, this is the slowest, most anemic recovery we have seen maybe ever, since the Great Depression at least. And we have had median income fall by $2,300 per family. We have had a 15 million increase in population and a decline in people actually working. And we have got more people working part time. This is not a good trend. Whatever we are doing, we need to get better at it.

Thank you, Madam Chair.

Chairman MURRAY. Thank you.

Senator Whitehouse?

Senator WHITEHOUSE. Thank you, Madam Chair. Welcome, Chair Yellen. Thank you for being here with us today.

Many reports on the economy show continuing improvement. The stock market is higher, unemployment continues to go down. There are elements to the economy that are flourishing. But I urge you to remember that there are locations in the country where the recovery really has not been experienced much. One is my home State of Rhode Island where unemployment is still at 8.7 percent, and although that puts us in unhappy position of being the leading State in the country, there are similar geographic areas in larger States that are experiencing similar difficulties.

We are a long way from the boom of Wall Street. We are a long way down the pipeline from the natural gas boom. We are a long way from the big interventions, like the auto industry rescue, that were so beneficial in the Midwest. And I guess two things:

One, I urge you to not be beguiled by the national numbers into forgetting the areas where it is still very difficult locally;

And, second, to ask you what policies you think might be helpful for those States and areas, geographic areas, that are still suffering economically.

Ms. YELLEN. I agree completely with your characterization of the national situation. There are pockets of the country that are doing extremely well, in part the areas where energy production is very strong, and some other areas as well.

But I think your description of the situation in Rhode Island, many areas of the country share the problems that you describe. Our objective in monetary policy is to continue to maintain an accommodative monetary policy for as long as necessary to see recovery of the labor market to a state—it is hard to know exactly how to characterize it quantitatively, but what the Federal Reserve Act calls “maximum employment” or we used to call “full employment” for short. And in many ways, we are far from that, and that is part of the reason why not only is there a shortage of jobs but also I think wages are rising as slowly as they are. And our mission is both to make sure that inflation moves back up to our 2-percent objective, but also to want to foster continued recovery in the labor market to help Rhode Island and other places like it.

Senator WHITEHOUSE. One of the ways that I find I can help at home is to help support infrastructure projects, particularly since we have a national infrastructure deficit in a great number of areas—highways, water facilities, so forth.

From the sort of high perch that you look down on the economy from, is there a difference between spending that goes out the door in the form of essentially expense and spending that results in a tangible asset that remains in the United States of America as a highway or a water treatment plant or some other facility?

Ms. YELLEN. The way I would look at it in the short run, in terms of creating jobs in the economy and for trying to get output back up to the potential of what we can produce, it does not matter where the spending occurs; it does not matter whether it is for a capital investment or something else—

Senator WHITEHOUSE. It is valuable either way in that sense.

Ms. YELLEN. But from the standpoint on long-run growth, it does make a great deal of difference what the spending is on, and investment spending and capital formation helps not only create jobs in the short term, but to promote growth in the long term.

Senator WHITEHOUSE. So there is an immediate value to spending in either direction in terms of economic recovery, but the long-term value is for the spending that is on infrastructure that creates a lasting asset.

Ms. YELLEN. Right. And I think one of the reasons we have seen a decline in the productivity growth over the last several years is that firms have been spending less and doing less capital formation. So this holds not only on the public investment side; it holds on the private investment side as well. And that is in a way one of the ways in which this shortfall, this recession that we are still recovering from has served to harm the growth of the economy over the medium or longer term.

Senator WHITEHOUSE. My time is up. Thank you for being with us.

Thank you, Chairman.

Chairman MURRAY. Thank you.

Senator Johnson?

Senator JOHNSON. Thank you, Madam Chair.

Welcome, Madam Chair. It is nice to meet you.

Ms. YELLEN. Thank you.

Senator JOHNSON. My background is in education, as an accountant, and as a manufacturer, so it is in my DNA to go to root cause analysis and I also like numbers. You mentioned earlier the 20-, 30-, 40-year outlook and how that is unsustainable from a debt-to-GDP ratio. Have you looked at just the dollar amounts of deficits that is going to be driving that debt?

Ms. YELLEN. You know, I guess I have. I often focus on what is the ratio of debt to GDP and is it stable or rising.

Senator JOHNSON. Well, one of the reasons I go to dollar deficits is it is something I think people can understand a little better. CBO seems to be kind of resistant to put their projections, so I have done it for them. They like percentage of GDP; I like dollars. So their baseline projection over the next 30 years—and I think that is a pretty relevant time frame; we have that demographic bubble—shows $66 trillion of deficits. That is the baseline. The alternate fiscal scenario is $127 trillion of deficits, so let me just break that out by decade for the alternate fiscal scenario. It is $8 trillion the first decade, $31 trillion the second decade, $88 trillion the third decade.

Does that comport with basically what your understanding is of the unsustainable nature of our debt and deficit over the 30 years?

Ms. YELLEN. Yes. I mean, my understanding of the core problem is that as the population ages—and, of course, it depends on the trend in health care costs relative to other prices in the economy as well, which had historically been one of rising relative—

Senator JOHNSON. That is—again, but my point, that is pretty accurate in terms of the numbers I am looking at, and that is completely unsustainable. By the way, my daughter just turned 31. That just kind of went by like that, so this is not that far out in the future. We need to address this sooner rather than later.

I want to hone in on Social Security. Whether you take a look at the trustees' report or CBO's, somewhere between $13 and $15 trillion will be paid out in benefits that exceed the payroll tax over the next 30 years. Is that pretty much your understanding?

Ms. YELLEN. So I do not have those numbers at my fingertips, but—

Senator JOHNSON. That seems about correct.

Ms. YELLEN. But eventually that begins to occur.

Senator JOHNSON. Okay, because I have been trying to get people—and I actually had CBO Director Elmendorf admit this, but I just want to ask you if you agree with this statement in an OMB publication talking about the trust fund. It says, "...these trust balances are assets of the program agencies and corresponding liabilities of the Treasury, netting to zero for the Government as a whole." Do you agree with that assessment? In other words, you have $2.6 or $2.7, $2.8 trillion of the U.S. Government bonds in the trust fund, but the Treasury has the offsetting liability. Is that correct?

Ms. YELLEN. Yes.

Senator JOHNSON. And so when you consolidate the books of the Federal Government, that nets to what?

Ms. YELLEN. Well, it nets to zero.

Senator JOHNSON. Zero. So the trust fund really has—to the Government as a whole, has no value. Do you agree with that?

Ms. YELLEN. The way I look at it, what is the ratio of spending on programs like Social Security—

Senator JOHNSON. No, again, I want to hone in on Social Security—really I want a very simple answer. Social Security will pay out $15 trillion in benefits over the next 30 years more than it takes in in payroll tax, and the trust fund has no value to the Federal Government. That is a correct statement, is it not?

Ms. YELLEN. Well, no, I would not have phrased it exactly that way. I mean—

Senator JOHNSON. Well, that is the way I am phrasing it, and I am phrasing it correctly, am I not?

Ms. YELLEN. The Government has essentially provided the Social Security fund with IOUs that says that we will make—

Senator JOHNSON. Right, asset offset by—

Ms. YELLEN. —these payments and—

Senator JOHNSON. —liability netting to zero, okay.

Ms. YELLEN. —the rest of the Government needs to come up with—

Senator JOHNSON. Let me move on to jobs. Do you agree with CBO's assessment that an increase to the minimum wage, the one proposed, would cost us jobs? Up to a million is what CBO estimates.

Ms. YELLEN. I do not know what the exact number is. I—

Senator JOHNSON. But it will cost jobs.

Ms. YELLEN. It will help individuals who benefit from a higher wage at the expense—

Senator JOHNSON. But it will hurt individuals that do not have a job, correct?

Ms. YELLEN. It is likely to have some negative effect on jobs, and it is a question mark exactly how large that impact is with different studies coming up with different numbers.

Senator JOHNSON. So with the Fed's dual mandate looking at trying to improve the employment situation, does the Fed ever consider the effect that its low interest rates—the incentive it creates for manufacturers to automate? Because I am seeing that. As I visit factories around Wisconsin, I am seeing functions that I never thought would be automated. For example, just a hand tow motor truck, automated. So now there is not a person that has to operate that anymore. It is just flying around the factory by itself, or maneuvering. Do you consider the harmful impact of these very low interest rates on the incentives to automate and also reduce employment?

Ms. YELLEN. Those investments raise productivity, and in the long run, that is good for the economy. And in order to have enough jobs in this economy to put people to work, we do not have to ask firms to avoid making investments that are profitable for them, that improve productivity. We need to expand demand in the economy so that there is enough economic activity, even if it is capital-intensive economic activity, that creates jobs for people who want to work. So that is what we are trying to do.

Senator JOHNSON. My point is just the misallocation of capital being caused by the very low interest rates, but my time is up. Thank you, Madam Chair.

Chairman MURRAY. Senator Nelson.

Senator NELSON. Good morning. Thank you for your public service. I am concerned that we are getting too much in a trend of the haves and the have-nots, with a shrinking middle class. The political and economic stability of this country for two and a quarter centuries has been because we have had a broad middle class and an aspiring middle class. Could you comment on the direction of the country's economy?

Ms. YELLEN. I agree with you, I am very concerned about trends toward rising income inequality in the country and trends that have affected the middle class. Partly this reflects a weak economy and a weak job market that is only gradually beginning to get back to normal. So a downturn in the economy tends to have a disproportionate impact on middle-income and lower-income families, and we have seen that. And putting in place policies that promote recovery will help, I believe, in that dimension.

But there are also longer-term trends that are contributing to what you are describing that are quite disturbing, and I think some of them have to do with technology, with technological trends that have shifted the demand for labor to very high skilled workers and away from those with less education, and, in addition, trends in globalization and the global economy. And these are longer-run structural shifts that I do think policymakers, it is something the Fed cannot address all of the causes of this, but a broader range of public policymakers, including Congress, I think should be focusing on policies that could help. I find this a very disturbing trend as well.

Senator NELSON. If the rich are getting richer and the poor are getting poorer and the broad middle class is constricting, it sounds like from a policy standpoint that we need to reverse those trends to encourage what has caused the political and economic stability. Do you want to suggest any policy changes that we in the Senate should consider?

Ms. YELLEN. I do not want to give you detailed policy advice, and there are a long list of things you could consider. But I would say that on anybody's list, training, education, a wide range of policies that make it possible for people to obtain the kind of education they need to have the skills to succeed in this economy, there is a great deal of work on the benefits of early childhood education and, of course, access to loans that enable people to obtain a good college education, a wide range of job training programs, and so forth I think would be on anyone's list of things to consider.

Senator NELSON. Amen to all of that. Thank you.

You no doubt are aware of the Tax Code provision that has expired that Senator Stabenow and I are trying to remedy where, if someone who has been very unfortunate, the only way out in losing their home is a short sale, that is the least painful way, and then lo and behold, they now find that that is considered as income, taxable income.

Just to give you three quick examples from my State, which, of course, the housing market was hit enormously hard in Florida, but here is someone that, after they exhausted all their savings, had to sell their home, and they happen to sell the home in 2014, not before the end of the year in 2013, and so they have got to pay income tax.

Another one, they lost their family business, bankruptcy, now losing the home due to foreclosure and a short sale, they were able to work out. But lo and behold, now they have an additional financial obligation of the income tax.

And so, too, in a third example, they had a contract to sell before the end of 2013. It got delayed, and that delay of a few weeks then causes them this additional thing.

Now, we are trying to remedy that. Do you want to comment on that?

Chairman MURRAY. Very quickly, because, again, we have a lot of Senators and a short time frame.

Ms. YELLEN. I think that in my role it is important for me not to weigh in on detailed specific changes in fiscal policy or taxes, but, of course, the recovery of the housing sector is very important, to see that ongoing is important to our recovery and has been, a very important factor in the downturn.

Chairman MURRAY. Thank you.

Senator Ayotte?

Senator AYOTTE. Thank you. I want to thank you for being here.

I wanted to ask you about, according to reports, FSOC is considering designating asset managers as systematically important financial institutions. And as I understand it, two companies have already advanced to stage two of the designation process. And what I would like to understand is that I believe that asset management business is completely different from the banking business or in many ways very different, and that the risks are different.

So I guess I would ask you, do you agree that asset management and banking are different? And can you help me understand also, as I understand it, the designation of asset managers as systematically important financial institutions that the FSOC council announced it is going to hold a public forum on asset management, but they have already moved two companies to stage two, so it seems like the cart got before the horse there. So if you can help me understand that as well.

Ms. YELLEN. To start off, I would say certainly asset managers have very different characteristics than banking organizations. FSOC does not comment publicly on individual firms or where they might be in the process, and so I do not want to comment on what firms are under consideration or where they might be in the process. But it has been FSOC's procedure all along to do extremely detailed analysis of the specific characteristics of the firms that they are looking into and considering for designation. There is no one size fits all in terms of analysis, and what they are looking to see is, is there some way in which the distress of a particular firm could give rise to systemic risk for the financial system and the economy? And that can occur through a number of different mechanisms that they have specified, and it will be necessary, if they consider such firms, to really identify clear ways in which the failure of these firms could trigger systemic risk.

Senator AYOTTE. And if they are designated that way, asset managers potentially—I know that this was one of the issues that has been raised—that would serve as a designation of potentially too big to fail, which could, as we have seen historically, make them eligible for taxpayer assistance in a crisis situation. And what we do not want is that to encourage them to take on more debt or more risk.

So can you comment on that criticism of putting asset managers perhaps in that category?

Ms. YELLEN. They are not, to my understanding, really eligible for taxpayer assistance in a crisis. The Federal Reserve is authorized to lend to depository institutions, and we are not authorized except in a systemic risk situation through our 13(3) powers to—we can design broad programs to cover sectors of the economy that may be impacted by difficulties in gaining access to credit. But we have no authority to lend to individual firms, and if these firms are systemic, their failure can cause financial instability problems, that is a reason for them to be designated and subject to risk standards and potentially capital and liquidity standards that would reduce the odds that they could fail.

Senator AYOTTE. Well, one of the things we want to just ensure is that hopefully we are not encouraging more risk by saying, you know, you have got that taxpayer backdrop, given the history of where we have been.

I wanted to ask you about an important issue that I know you have already made some comments on. You know, I am hearing so much from our community banks that they feel incredibly burdened by Dodd-Frank. And as you look at the history, the number of banks is decreasing in the country. And it seems what I hear is a one-size-fits-all solution. And I know that you recently commented about this issue at the Independent Community Bankers conference.

Ms. YELLEN. Yes, I did.

Senator AYOTTE. Can you tell me what your thoughts are about how we can address this concern for community banks, smaller banks, so that they do not get swallowed up with the regulations that may not fit necessarily because they were not the big systematic institutions that caused some of the—or put us in a situation we were concerned about?

Ms. YELLEN. I completely agree with you that community banks were not the source of the financial crisis, and my colleagues and I do not want to see them caught up in unnecessary regulatory burden. We are very attentive to the need to reduce regulatory burden for these institutions to make clear that most of the regulations that we are putting in place to address systemic risk that affect larger institutions do not apply to these smaller institutions. Whenever we put out a regulation—an example would be our recent capital regulations implementing Basel III—we put out a special guide to show what is relevant to community banks, that they can ignore and are not affected by the rest. I know that they—there is no question they do feel that banking regulation has become more burdensome, but I pledge that I will continue to work with my colleagues to do all that we can to make sure that we reduce the burdens on these community banks and do not in any way have a one-size-fits-all approach. I do not think that would be appropriate.

Senator AYOTTE. Thank you for that.

Chairman MURRAY. Thank you.

Senator King?

Senator KING. Dr. Yellen, thank you very much for being with us. I would urge you to search YouTube and put in "Jimmy Stewart Wonderful Life." The very first 2-minute clip is an exchange between George Bailey and Mr. Potter that captures so much of what we are talking about here today. And I would just say, "Gosh, Ms. Yellen, gee whiz," channeling Jimmy Stewart, "how about putting a community banker on the Federal Reserve Board? Don't you think that would be a good idea?

Ms. YELLEN. I am in favor of that.

Senator AYOTTE. I agree.

Ms. YELLEN. I certainly am in favor of that. We just lost two individuals who were very familiar with community banking: Governor Duke, who ran a community bank in Virginia and had a lifetime of experience in community banking; and Governor Raskin, who has now moved to become Deputy Treasury Secretary, who served as Commissioner of Banking in Maryland and got to know the community banks and the community bank regulatory issues very closely. They made huge contributions, and I would love to see a replacement.

Senator KING. I hope you will convey that sentiment to the White House, please.

Ms. YELLEN. I have done so. Thank you.

Senator KING. By the way, I met with a group of bankers from Maine, just to underscore the point you made earlier about a little weakening in the housing market, that is what I was hearing from them. They are seeing a marked decline in new mortgages, and I realize the plural of anecdote is not data, but it is getting close, and I think that is something we need to pay attention to.

I was at a panel recently on economics, and there were two questions that were unrelated to each other, but it seems to me they are related. One was about why is this recession recovery so sluggish, and the other was about the gross income inequality, the data of 95 percent of the income growth in the last few years has gone to the top 1 percent of the population.

It seems to me those two things fit together. If two-thirds of the American economy is driven by consumer spending and the income is going to the top 1 percent and not to the people who do the spending, isn't that a contributing factor itself to the sluggishness of the economic recovery, the lack of demand?

Ms. YELLEN. We have been trying to stimulate demand. Greater spending is the key to trying to get the economy to operate—

Senator KING. But what I am saying is the consumers who generally drive the economy do not have the—are not getting the income.

Ms. YELLEN. That clearly is a factor that is relevant, the pace of expansion we have seen, yes.

Senator KING. And the famous book that has just recently come out by Mr. Piketty that talks about the drag worldwide by income inequality, have you had time to digest that? It is only 1,000 pages.

[Laughter.]

Ms. YELLEN. I cannot say I have to the last page of it, but I am certainly familiar with the book.

Senator KING. Well, it just seems to me it is something—again, going back to the basic principle that two-thirds of our economy is driven by consumer spending, Henry Ford, 100 years ago this year, had this insight, doubled the pay of his workers so they could buy his cars. And we have got to start thinking that way again.

Ms. YELLEN. Many economists have argued that the distribution of income does matter to the pace of spending, and, I do not know with any utterly clear evidence on this topic, but it makes sense to assume that households that would tend to spend a great deal of their income when income distribution shifts in the direction of those who are wealthier and likely spend at the margin less of their income that creates a drag on the economy. And a number of economists have certainly made that argument.

Senator KING. In the 1 minute left, I want to turn completely and talk about the issue of debt, which several of your questions have talked about. I think you have articulated an intelligent strategy, which is be careful about short-term, abrupt fiscal changes to deal with the debt, because that, in effect, as you characterize it, is a headwind for the recovery.

Ms. YELLEN. Right.

Senator KING. On the other hand, we cannot ignore this. I mean, the debt, just the interest on the debt, if we have a 1-percent increase in the interest we are paying on our current Federal debt—1 percent—which I think everyone agrees is likely within the foreseeable future, that will suck more money out of the Federal budget than the sequester.

Ms. YELLEN. I would agree that interest does matter to spending and to the accumulation of debt. I would also want to point out, though, that interest rates are unlikely to begin rising until we are in a strong economic recovery. So we eventually will start to raise interest rates. I mean, I am assuming the economy will continue to recover, and at some point that will become appropriate. But in thinking about what will happen with deficits and the debt, it is important to keep in mind that a stronger economy will be very good for the Federal budget deficit. There will be stronger revenues coming in and a decline in social safety net spending, and that will be an offset, and probably the most important element for the deficit and the evolution of the debt. Yes, interest payments will go up, but I believe the larger piece of it is likely to be that a stronger economy will improve the budget. So both of those things are operative.

Senator KING. So a long-term strategy, not a short-term emergency strategy, is what we really need to be looking at.

Ms. YELLEN. That is what I would urge.

Senator KING. Thank you.

Thank you, Madam Chair.

Chairman MURRAY. Thank you.

Senator Graham?

Senator GRAHAM. Thank you. Let us continue. That was a very interesting conversation.

So it is good news if interest rates go up?

Ms. YELLEN. It is likely good news if interest rates go up. I mean—

Senator GRAHAM. Compared to historical averages, how would you say interest rates are today? Are they unusually low?

Ms. YELLEN. Absolutely.

Senator GRAHAM. Okay. So what you are saying is sort of like a cocktail. Interest rates go up. That means more interest payments on the debt. It affects long-term and short-term indebtedness, right?

Ms. YELLEN. That is correct.

Senator GRAHAM. But it would be offset by a stronger economy.

Ms. YELLEN. Right. We—

Senator GRAHAM. Would it be one for one?

Ms. YELLEN. I think most projections would suggest that, as growth picks up and we are getting the economy moving back toward full employment, the effect—I believe this is the case—of higher output on the economy, that the impact of that on the Federal budget deficit would be larger than the likely impact, the negative impact of higher interest rates.

Senator GRAHAM. So it would be actually a net positive.

Ms. YELLEN. I believe it probably would for a time. You know—

Senator GRAHAM. Okay. I got you. I got you. We got to move on.

Sequestration—if it is fully implemented as envisioned beginning in 2016, what effect will it have on our long-term national debt—small, medium, large, insignificant?

Ms. YELLEN. What matters is the overall size of budget—

Senator GRAHAM. Sequestration itself. Would you agree with me it would have very little effect because it is not reforming entitlements, it is just all discretionary spending?

Ms. YELLEN. I guess I would say that it is not something that addresses the long-term problems that are—

Senator GRAHAM. Well, what are the long-term problems?

Ms. YELLEN. I think what shapes the long-run trajectory of—

Senator GRAHAM. Isn't it the retirement of the baby boomers?

Ms. YELLEN. Yes. It is the fact that—

Senator GRAHAM. Like 80 million of us are going to retire in the next 20 to 30 years and we are going to swamp Medicare and Medicaid and—Medicare and Social Security. Is that—

Ms. YELLEN. The projections are that Medicare, Medicaid, and Social Security would roughly double as a share of GDP.

Senator GRAHAM. And the projections said that about 2042 all the projected revenue would go just to pay those payments and no money left for anything else?

Ms. YELLEN. That is the dominant trend. It depends on—

Senator GRAHAM. Okay. So the real long-term effect—

Ms. YELLEN. —health care costs as well.

Senator GRAHAM. Right. The long-term effect on the country, what makes this grease, what puts us in an unsustainable situation is the baby boomer is going to retire, and it is just going to take all the money to generate to pay the bills with the entitlement systems there are today. That is generally—and if you do not reform entitlements, you are not going to fix this problem. Do you agree with that?

Ms. YELLEN. I think both revenues and spending matter—

Senator GRAHAM. I did not say how. I just said—

Ms. YELLEN. —Congress to—

Senator GRAHAM. Well, can you raise enough taxes to fix this problem?

Ms. YELLEN. That is really a decision for you to make.

Senator GRAHAM. I mean, is it possible to raise enough taxes to fix this problem? What if you took every penny from everybody that made over, you know, the top 1 percent? Could you get us out of debt?

Ms. YELLEN. I do not know the answer to that and—

Senator GRAHAM. Well, I do. No.

Now, when it comes to our tax system, would you support a territorial tax system?

Ms. YELLEN. I do not intend to weigh in on particulars about—

Senator GRAHAM. Do you agree with me that under the current Tax Code trillions of dollars of money held by American corporations that do business overseas are not coming back into this country with a 35-percent tax rate?

Ms. YELLEN. We have seen some trends toward—

Senator GRAHAM. Why don't you ask them? Why don't you just go to the top people and say, "Are you going to bring the money back?" Pfizer is going to move their headquarters overseas. I mean, this is not that hard to figure out. Just call up somebody who has got one of these big companies and say, "What would happen if we had a one-time good deal where we could take the money and apply it to infrastructure spending, something we all agree, would you bring the money back?" Would you call up some of the major companies and ask them that question on my behalf?

Ms. YELLEN. We talk to business executives—

Senator GRAHAM. I am asking you to ask them that question. If we had a one-time good deal to repatriate money held overseas, would they take advantage of it? Okay?

Now, let us talk about Obamacare. Do you believe that if the incentive in the law is to, if you are not covered, if you hire somebody for 29 hours versus 40, a lot of people are going to wind up with 29 hours of pay? Is that a likely possibility that an employee who works 29 hours, is not covered by the mandate of an employee who works 40, can you see a scenario where a lot of employers will reduce hours? Do you think that is a likely possibility?

Ms. YELLEN. The magnitude of that effect is something that one has to look at empirically.

Senator GRAHAM. Very quickly, if you have over 50 employees in the future, every employer will be covered by the mandate, could you see a scenario where a company of 48 employees would not hire 3 more?

Ms. YELLEN. Such incentives are present. I do not know how large they are.

Senator GRAHAM. Well, you need to talk to people about this, because I can tell you, I do not think I would. If I had 48 employees, I do not think I would hire 3 more if everybody was covered by Obamacare.

Last, if you make $46,000 as an individual, you are entitled to a subsidy somewhere in that range, 46, 47. Would you take a promotion for $50,000?

Ms. YELLEN. So—

Senator GRAHAM. You would lose your subsidy, or at least part of it. Thanks.

Chairman MURRAY. Senator Kaine.

Senator KAINE. Thank you, Chairwoman Yellen. Great to have you here today.

I want to ask a first question about the management—economic wisdom about the management of debt. I was a mayor and Governor, and we had debts for capital purchases. We did not manage our debt either in a city or State by a total debt number, we will not go over this number. We managed it by ratios. Usually ratios of debt service payment to annual budget or in some instances total debt to gross city or State product.

There has been controversy about the study most discussed, this Reinhart-Rogoff study. We have talked about it a lot here in this Committee over the last year and a half.

In your work with the Fed, what is the current sort of best economic wisdom about the levels of debt and what ratios we should be looking at to keep debt within acceptable levels in Federal budgeting?

Ms. YELLEN. There has been, as you mentioned, a great deal of controversy over Reinhart and Rogoff, so I do not have a number to give you about what is a safe level of debt to GDP. But I think it is essential that the path of debt to GDP be one that is sustainable over time. And we can see, as we have seen in the case of some European countries over the last couple of years, that when a country is seen to be on a path where debt to GDP is not only high but is projected with current spending and tax policies to be rising unsustainably, that can have an exceptionally negative effect and begin to drive lenders away, and we see interest rates rise.

Now, the United States has never seen anything like that. I think for us it is known that changes have to be made to put our debt to GDP on a sustainable course, but that we have enough time and have a good enough record as a country in making these policy changes that we have not seen any impact in our own financial markets I am aware of.

Senator KAINE. I think the discussions we have been having around here generally sort of focus on publicly held debt as a percentage of GDP. You would rather be in the low 70s rather than the high 70s. We have been trending downward, which is positive. There are some demographic trends that you have discussed that we would have in out-decades. It is starting to trend back up in a pretty significant way.

If we are sort of using that as sort of our rough strategy to try to manage—did that and better to be trending toward the low 70s than the high 70s, does that set off, you know, red lights in your head like, no, that is probably the wrong way to approach this?

Ms. YELLEN. It does not set off red lights.

Senator KAINE. Okay.

Ms. YELLEN. But as you go out and you see the trend is heading up, that is what is worrisome to me.

Senator KAINE. And that is a little bit like the back and forth you had with Senator King about short-term versus long-term and the different challenges in each time horizon.

Ms. YELLEN. That is right.

Senator KAINE. The pace of the recovery has been a topic we have been discussing today, and something that I wanted to get into is uncertainty is affecting the recovery, congressional budgetary uncertainty. So long periods of time without budgets, the imposition of a sequester that all Congress said, "We do not want this to happen. This will be a bad thing. We are setting it up as a punishment to force us to find a deal. But if we do not find a deal, we allow the sequester to occur after we have said it is going to be bad."

Government shutdown, continuing resolutions, which, as I describe to my constituents as spending by looking—it is like driving by looking in the rearview mirror rather than the windshield, we just do what we used to do. Flirting with debt ceiling default.

To what extent has the kind of combined weight of congressional budgetary uncertainty been a factor in the slow pace of the economic recovery?

Ms. YELLEN. It is just impossible to put a number on that, but in discussions that my colleagues and I have had with businesses and members of the public, this is a topic that comes up very frequently as contributing to an overall sense of uncertainty that I think inhibits spending, inhibits hiring and business investment.

And while I do not know just how important it is, there certainly is work suggesting that policy uncertainty and uncertainty more broadly about the path of the economy has been something that has depressed the pace of the recovery.

Senator KAINE. And so, for example, doing a 2-year budget deal, the Murray-Ryan budget deal in December, the first 2-year budget in Federal history to give people some certainty, doing a full appropriations set of bills in January, getting over a debt ceiling discussion with no flirting with default or gimmicks in February, those are the kinds of things that—would you suggest we should be more like that in the future?

Ms. YELLEN. That does seem like a positive in terms of providing confidence to businesses and the public.

Senator KAINE. Thank you, Madam Chairwoman.

Chairman MURRAY. Thank you.

Senator Wicker?

Senator WICKER. Thank you, Dr. Yellen. We have a national debt of $17 trillion. How much of that does China hold?

Ms. YELLEN. I do not have the number at—

Senator WICKER. If I have a chart here that says $1.3 trillion, that would be about right?

Ms. YELLEN. That is probably right.

Senator WICKER. And Japan next at $1.2 trillion. Let me ask you, I also have some information that with regard to this foreign debt, some 70 percent of it is actually held by governments and some 30 percent is attributed to private foreign investors, Japanese banks, for example. So we have got a $17 trillion debt, these big Asian countries with a lot of it. What should we worry about? Do you worry about the $17 trillion? Should we be concerned in this Congress about the fact that the Chinese and Japanese own so much of it? What do you worry about as Chairman of the Federal Reserve?

Ms. YELLEN. I worry about, as we have discussed here, the long-term path of the debt and whether or not it is sustainable. U.S. Government debt is regarded as the safest of safe assets, and it is very much in demand globally among investors who want security.

Senator WICKER. That is a good point. What rate of return do these investors receive today on U.S. debt?

Ms. YELLEN. Well, a 10-year Government bond is a little bit over 2–1/2 percent, and so this is a safe return, and—

Senator WICKER. Why do they continue to purchase—why do these governments continue to purchase our bonds, Chairman Yellen?

Ms. YELLEN. Because they have confidence that it is an extremely safe investment, and I hope it also suggests and believe it suggests that they have confidence in the Federal Reserve as an institution that is committed to maintaining price stability and a sound dollar. And so in addition to what Congress does with respect to future deficits, our management of the economy, our commitment to keep inflation as close as we can to our inflation objective of 2 percent, this is also an important factor.

Senator WICKER. What alternatives do they have? And what could tip the balance away from them choosing to invest further in United States securities?

Ms. YELLEN. I think—

Senator WICKER. What is their next choice?

Ms. YELLEN. They have many other choices of assets that they can purchase. I think if we were to lose their confidence, either by a failure to address long-term debt problems, fiscal problems, or by mismanagement by the Federal Reserve, then we—

Senator WICKER. Well, let me ask you about the long-term issue, and Senator King mentioned this. If the economy improves as you expect it to, the $221 billion we pay each year in interest on the national debt, that will double. Is that correct?

Ms. YELLEN. It depends on what happens to interest rates, but, yes, as the economy recovers and as inflation moves back toward our objective, the Federal Reserve eventually will begin to normalize monetary policy and raise short-term interest rates.

Senator WICKER. And so the 227 billion that we paid-the 221 that we paid in fiscal year 2013 or $227 billion that we expect to pay in this fiscal year would double to somewhere close to half a trillion in interest on the national debt under that scenario, would it not?

Ms. YELLEN. Well, it certainly would go up.

Senator WICKER. Let me ask you also, yesterday I had the opportunity in another committee to have a conversation with you. You expect the asset purchase program to end in the fall of 2014. What variables could occur to make the Fed alter that decision and continue the asset purchase program?

Ms. YELLEN. What we need to see in order to follow that plan is continued improvement in the labor market and an overall pattern of growth that is sufficient to cause us to project continued improvement—

Senator WICKER. Can you modify that improvement? What degree of improvement?

Ms. YELLEN. Our objective is to make sure that the economy moves back to full employment or maximum employment, and we are making gradual progress. We have made considerable progress since we started the asset purchase program. Whenever we meet, we ask ourselves the question: Do we continue to believe that the economy is on a path that will take us toward our objective of reaching full employment or maximum employment? And we also think about inflation, which is running below our 2-percent objective, and ask ourselves: Does incoming evidence suggest that inflation will also be moving back up to 2 percent over time? And if the answer to those two questions is yes, we will continue to reduce the pace of our asset purchases.

Now, if the economic outlook were to change in such a way that we no longer felt that the answer to those questions was yes, then we would reconsider our plans.

Chairman MURRAY. Thank you.

Senator Stabenow?

Senator STABENOW. Thank you very much, Madam Chair, for holding the hearing, and, Dr. Yellen, thank you very much for being here. And let me first say thank you for being prudent as you move forward on decisions and for recognizing that jobs and the economy matter, so I appreciate very much your thoughtful, deliberate approach.

I also wanted to associate myself with my colleagues Senator Ayotte and Senator King and others on community bankers, so let me just say we certainly appreciate and need there to be an understanding that they did not cause what happened and are very much at the front lines of helping us get out of any recession that we still have, which we do for many, many middle-class families.

I want to speak just for a moment before asking a question. When we talk about why would people invest in the United States, I think there are a lot of great reasons in terms of rule of law and stability and the manufacturing renaissance that is coming, the low natural gas prices that are helping to fuel that. We, in fact, have a deficit, Madam Chair, as you know, that since 2009, since the President came into office, is down by about two-thirds, about 66 percent. Any other time there might be ticker-tape parades and speeches on the floor about bringing down the deficit that much. We are seeing stock markets double, basically double since the spring of 2009. Also at other times, if there was a different President, a different party, I think we would be hearing very different things about the economy improving. And so I just want to say for the record the economy is improving.

My biggest concern—and I know many, of my colleagues share this—is that it is not improving for everyone. And we have an economy based on supply and demand, very focused on supply, waiting for things to trickle down, and too many people are still waiting for things to trickle down. And the demand part of this is critical.

So before I ask any questions, I do want to also say that if we were to line up 774 people around this building, 774 people making minimum wage, which still keeps them below the poverty level, still keeps them on food assistance, still keeps them on additional health care help, you could line them up, and that would equal one average CEO's salary in this country. That is a problem for us if we, in fact, have an economy based on two-thirds consumer spending.

So when colleagues talk about raising the minimum wage or equal pay or giving folks a fair shot, I just want to one more time toot the horn of a great Michigan person, Henry Ford, 100 years ago, as Senator King mentioned. He doubled his workers wagers—which, by the way, if it was today's minimum wage would be almost $15 an hour. Because of this small businesses thrived. He was heavily criticized by the Wall Street community saying the world was going to end. It did not end, and he became one of the wealthiest men of his generation. So I would take that any day.

On to my question. As we see deficits coming down, there is one area of deficit that continues to go up which is of great concern in terms of the economy, and you mentioned education. We now have total student loan debt over $1 trillion, which is more than credit card debt. A huge issue. Seventy percent of the students have to borrow money to attend college and leave with nearly $30,000 in loans. Talk to a medical student, or others in grad school, it is much, much higher.

So could you talk about what you would see as the estimate of the impact of student loan debt on the economy and the costs for us as we try to continue to come out of this recession and keep our middle class?

Ms. YELLEN. I certainly agree with you that student loan debt has risen at a very rapid rate. I always start, though, by—I think it is important for us to recognize how important it is to be able to get education and to have access to loans that will improve earning power over time.

That is always my starting point in thinking about this. But I do worry, for example, when students are taking on heavy burdens of debt, which cannot be discharged in bankruptcy, do they really actually understand for starters what the benefits will be of the programs that they are involved in? Are they being given appropriate information about what the benefits of a particular program are in terms of placement, completion rates, and so forth? Do they have good knowledge about the returns from the debt that they are taking on?

But the debt loads certainly are high enough that they may play a role, for example, in making it hard for people to buy first homes, to build a downpayment, and that may be an effect that we are seeing right now already in the housing market. I do not know of clear evidence of it, but there has been just a huge increase in debt. And for families that get into trouble with student debt, it is something that cannot be discharged in bankruptcy. And it can represent a very heavy burden for an individual if things do not go well.

Senator STABENOW. And I might just add that it is also an area where we have not allowed refinancing at the low rates that you have created for other parts of purchasing in the home market and so on, which is why many of us have joined with Senator Warren in legislation that would allow those students to refinance at the lowest rate that we had all voted on last year, 3.86 percent, and get folks out of debt so they can buy that home, get that car, and be able to have the life that they want. So thank you very much.

Chairman MURRAY. Thank you very much.

We have three Senators who are left here in this order: Senator Grassley, Senator Coons, and Senator Portman. I have to go to another hearing, Sylvia Mathews Burwell's confirmation hearing, so I am going to turn the gavel over to Senator King. This is how you get senior really fast, Senator King, if you want to come up here and take over the gavel, and I really appreciate your doing it. And I really want to thank you, Dr. Yellen, for your testimony today. We will finish with these last three Senators, and thank you very much, Dr. Yellen.

With that, I will turn it over to Senator Grassley.

Senator GRASSLEY. The American Enterprise Institute studied salaries of bank regulators and compared them to salaries of bank employees. They found that bank regulators on average made more than double the amount of their private sector counterparts. This study involved salaries of the Comptroller of the Currency office, the Federal Deposit Insurance Corporation, Consumer Financial Protection Bureau. The institute was not able to examine salaries of the Federal Reserve employees because the Fed refused to respond to Freedom of Information Act requests from Judicial Watch.

I ask this question because I am quite an advocate for transparency and disclosure because I would think it creates accountability. You have been called a leader in transparency at the Federal Reserve. To what extent would you provide detailed information about the salary of Federal Reserve employees?

Ms. YELLEN. Let me just start by saying with respect to general salary levels at the Fed, we benchmark what we pay very carefully on an ongoing basis to surveys of competition, including at other Federal regulators. We do release salary information. We have provided the names of individuals who are our top earners, individuals with salaries above $225,000. We have provided information on salary grades, including officer grades, and salary ranges that go with those grades. We have provided information on benefits that employees at the Board and the Federal Reserve receive, and our annual report contains total salary and compensation expenditures, so that is information that we are already providing.

Senator GRASSLEY. Then you must be telling me that Judicial Watch has been satisfied that they got the information that I was told they did not get from you? I guess my question is: What would be wrong with providing that information, a Freedom of Information request? What would be wrong with that? Wouldn't that be the thing to do? I mean, you are a public servant; your organization is a public institution. It seems to me like it should'nt be any different than any other, like the Comptroller of the Currency, the Federal Deposit Insurance Corporation?

Ms. YELLEN. We have provided this information in response to FOIA requests, including—

Senator GRASSLEY. Well, if you have and I am wrong, I am willing to accept that. I will get back to the people that I read about and the reason for my question. Let me go on to another one. And if they tell me you are wrong, I am going to be writing to you, and I want an answer why. You are a public institution; you are public servant. Why are you different than any other part of the Federal Government that will make the same information available?

On another question, in the past a conventional view among many economists was that there was an inverse relationship between inflation and unemployment. That is, rising inflation was associated with lower unemployment. Now, a couple decades ago, Milton Friedman challenged the view, claiming that over the long run this relationship actually breaks down as individuals begin to expect inflation. An example of his theory at work was the stagflation of the 1970s.

So just one question: Do you have any concerns that the high inflation and high unemployment that we experienced in the 1970s could happen again should the Fed act too slowly in reversing its easy money policies?

Ms. YELLEN. The Federal Reserve is very well aware of Milton Friedman's theory, and I am not aware of anyone in the Federal Reserve who adheres to the notion that there is a permanent tradeoff between unemployment and inflation. We all recognize that inflation expectations matter and can shift over time. All of us lived through the 1970s where we saw that happen. None of us want to or would be willing to see that happen again, and it is why in our statements we constantly reference the importance of inflation expectations and their stability and the fact that they are anchored in terms of describing our policy and how it will be conducted.

Senator GRASSLEY. How long will it take you to get your balance sheet down to $800 billion like it was in 2008?

Ms. YELLEN. We all expect our balance sheet to gradually decline over time after we regard it as appropriate to begin to tighten policy. We have not decided and will probably wait until we are in the process of normalizing policy to decide just what our long-run balance sheet will be. But clearly it will be substantially lower than it is now, and it will take a period of a number of years. This could happen simply by ending our reinvestment policy at some point. If we did that and nothing more, it would probably take somewhere in the neighborhood of 5 to 8 years to get it back to pre-crisis levels.

Senator GRASSLEY. Thank you, Mr. Chairman.

Senator KING. [Presiding.] Thank you.

Senator Coons?

Senator COONS. Thank you. Thank you, Dr. Yellen. Thank you for your leadership of the Fed, and thank you for your testimony here today and for your service. And thank you, Senator King, for chairing the hearing.

There were some exchanges previously about community bankers, community banks, and their potential role that I just thought was constructive and would encourage your continued thought in that direction.

Let me, if I might, move us towards a focus on inflation. Given that it is still well below the target of 2 percent, I would be interested in what you think are the consequences of it staying below 2 percent. In your written testimony, you talked about a variety of factors that might lead to inflation either re-emerging or staying low. And do you think there is any risk of our entering a deflationary period and what would be the consequences if that were to happen?

Ms. YELLEN. We have seen that deflation is associated with very weak outcomes, economic outcomes, in the rare situations where it has occurred. And it is something we absolutely want to avoid.

But even ignoring the risk of deflation, inflation that runs persistently at levels that are lower than our 2-percent objective also has economic costs. First of all, it raises the real or inflation-adjusted cost of capital, and it also redistributes debt burdens in the sense that when individuals take on debt, they have an expectation for how rapidly prices and their own incomes, wages, will be rising. And when those expectations are frustrated by exceptionally low inflation, debtors find that the burden of their debts is really greater, and that is something that constrains their spending.

So we want to avoid persistently having inflation both running higher than our objective, but also running lower than our objective on a persistent basis.

Senator COONS. Referencing back to the question perhaps that Senator Grassley asked, folks who grew up in the 1970s or in the 1980s implicitly, from your comments, have gut assumptions about inflation rates that are significantly different than the current period. Would there be some real benefits to having inflation exceed 2 percent?

Ms. YELLEN. We have to a point in this country we have now had a long period since the early or mid-1990s in which inflation has averaged 2 percent. And if you look at inflation expectations, they run around 2 percent. And they have been very stable and well anchored. And they have not moved around when actual inflation on some temporary basis has diverged from 2 percent, and that is a huge asset to this country, to have stable, well-anchored inflation expectations.

For example, when we have undergone periods in which oil prices have risen and there were a number of years in which, contrary to our in-the-markets expectations, oil prices continued to go up for a number of years, so headline inflation ran above 2 percent. With well-anchored inflation expectations, we did not see what happened in the 1970s. Namely, what should be a temporary period of inflation above our objective due to rising commodity prices,, in the 1970s, dislodged inflationary expectations—they rose. And then even when energy prices stabilized, we were left with permanently higher inflation. We have not seen that since the mid-1980s, and that is a huge asset to us in conducting monetary policy to be able to rely on it. So I would not favor trying to raise our inflation objective above where it is.

Senator COONS. Let me ask one other question. There has been a lot of conversation here and work around deficits and deficit reduction in the last few years. The American Society of Civil Engineers has given our national infrastructure a rating of D-plus. My own home State has a number of bridges that fail safety standards. I would posit that we have a significant infrastructure deficit as well as an innovation deficit because we are underinvesting in R&D relative to our main competitors. We are underinvesting in maintaining and upgrading our infrastructure relative to our main competitors.

Do you have any comment about what value it would be to our economy and to recovery of significantly increasing our short-term investment and then sustaining in a longer-term way our investment in infrastructure and in research and development?

Ms. YELLEN. Spending in the short term on infrastructure would tend to create jobs or stimulate aggregate demand. From a long-run perspective, I believe it has benefits for long-term growth. Studies of the factors that determine long-term growth consistently point to R&D, which influences the pace of technological change, productivity growth, as well as investment or capital spending, both private and public.

Senator COONS. Thank you. Thank you very much for your testimony.

Thank you, Mr. Chairman.

Senator KING. Senator Portman.

Senator PORTMAN. Thank you, Mr. Chairman. And thank you, Chairwoman, for being here today. I know you have had to answer a lot of questions today and a lot of things have been discussed. I guess one that I have always been curious about is when you say that you are going to begin to reverse this quantitative easing, which I view to be at historic levels, one thing you talked about is interest rates. And you said that if interest rates are below 6.5 percent, you will begin that process—

Ms. YELLEN. Unemployment.

Senator PORTMAN. I am sorry. The unemployment rate at 6.5 percent. First I look at the fact that people say we are at 6.3 percent unemployment now, but more to the point, are you taking into account the more fundamental weakness on the labor market side when you look at folks who have left the workforce altogether? As you know, if you were to take the labor force participation rate, which is the percent of folks who are actually looking for a job or working, and compare it to either before the recession or even when President Obama was sworn into office, the first one, if you compared those two rates, we would be at 10.8 percent unemployment right now. If you take it back to when President Obama was sworn in, it would be 10.4 percent.

So the 6.3 percent or 6.5 percent, for that matter, looks better than it actually is given the reality out there, and one of my colleagues said earlier that this is a weak recovery, another one said it is a real recovery, but not everybody is benefitting from it. I would tell you there are millions of Americans not benefitting, historic levels of long-term unemployment, who are counted in the unemployment numbers relative to any other recovery, and all these folks who have left the workforce altogether.

So are you taking that into account when you choose an unemployment rate to begin backing off on the easing?

Ms. YELLEN. Okay. If I could just clarify, 6.5 percent was an unemployment rate we named. It had the following significance. We said that as long as inflation was under control and the unemployment rate exceeded that level, we would not consider raising our target for short-term interest rates. So it was not something that we tied to our asset purchases. It was tied to the level of short-term interest rates.

Now, we did not say that we would start to raise our target for short-term interest rates when unemployment fell below 6.5. It was something we were simply trying to tell the public: Do not even think about the possibility the Fed will raise interest rates with unemployment in excess of that 6.5 percent level as long as inflation is not an issue.

It was not a trigger to start raising the level of rates. And we recognize that as we get closer to our goal of full employment, we cannot look at any single statistic in describing the state of the labor market, and everything that you mentioned—the level of labor force participation, trying to understand why it has fallen so much, what part of that is due to demographics, and what part of that is a reflection of a weak labor market—the fact that you mentioned that long-term unemployment is so very high and there is so much part-time employment that is involuntary, that we would have to factor all of those things and other facts about the labor market—

Senator PORTMAN. I understand that, and yet I would hope that you all would be looking at some of those other indicators of our economy, and—

Ms. YELLEN. We are indeed looking at those indicators.

Senator PORTMAN. And, by the way, I am not suggesting that you should not back off some of, again, what I view as unprecedented Federal Reserve quantitative easing, including setting interest rates at relatively low levels, because I do think there is some danger there. But in terms of the economy, I just do not think that the unemployment number reflects the reality. And, you know, in terms of the demographic changes you suggest, I would suggest—I am sure you have all looked at the Brookings study that talks about the fact it is not my generation, baby boomers, who are retiring early primarily. It is probably disproportionately young people, probably disproportionately men, probably disproportionately single men. And this economy is, therefore, in my view, not as strong as folks say.

Then the question is: What do you do about it? What should the Fed do? And I think there is this old saying, you know, if you have a hammer, every problem you see is a nail. And I worry that the Federal Reserve is trying to use its monetary policy hammer, in effect, to solve a problem that is really not a monetary problem, and at some risk by doing so. So that is my own view. When I talk to business leaders, I hear that the reason that they are not investing in plant and equipment and people has a lot less to do with interest rates and a lot more to do with the uncertainty in the economy.

There is a study—you probably say it out there—of 500 CFOs, chief financial officers, around the country saying—68 percent of them said they would not increase their business investments, no matter how low interest rates go. And they said that they will not even though they have got $2.5 trillion right now in excess reserves in banks and businesses are hoarding about $2 trillion of their own cash as well, we are told, sitting on the sidelines. That is not happening because they say there is uncertainty. And what they tell me is that it is about the debt. You talked about this earlier in response to some of the questions. The fact that we are heading toward just about 100 percent GDP to debt, right now we are about 74 percent, concerns them. And I hope it concerns us as policymakers.

Tax increases, they are concerned about when the President keeps proposing more tax increases. Certainly the Affordable Care Act and its effect on costs of doing business, what the EPA is doing and other regulations that increasingly move from the legislative branch to the executive branch, creating even more uncertainty, not knowing what the regulators will do. And I would say one of the uncertainties is Federal Reserve policy. One, they do not know what you are going to do, as you say, so many different factors so you really do not have a trigger; but, second, concerned about the potential impact of the unprecedented expansionary policies, in particular the possibility of a bubble as more and more people, not being able to invest in stocks and bonds and getting any return because rates are so low, are going into the equity markets, taking sometimes more risky investments on the stock market side and creating the potential for a bubble.

So that is a lot of, you know, commentary for you to respond to, but I would love to hear your response to that. Is, in fact, what the Fed is doing not responsive to the real problem based on the anecdotes that I am hearing, you are hearing, I am sure, in your various boards around the country and what these surveys are telling us, one? And, two, is what you are doing, in effect, making it even worse?

Senator KING. Madam Chair, before you begin, we have just been notified a vote has begun on the floor, so if you can respond to the very broad question with a very precise answer. Thank you.

Ms. YELLEN. Monetary policy is not a panacea, but I think maintaining a policy of low interest rates has been helpful in a number of ways. I think it has helped get housing back on track, helped the housing sector more broadly, house prices have risen. That has helped the financial situation of many households. We have seen a revival in car sales. For firms in terms of their investments, as you mentioned, many different factors matter, and interest rates, low interest rates, may be less of a factor in stimulating capital spending. But I think there are a number of sectors of the economy that have responded favorably to a policy of low interest rates, and it has helped stimulate demand and job growth. It has been one factor that has been helpful. Again, I would not say it is a panacea.

Senator PORTMAN. Thank you, Madam Chairwoman.

Thank you, Mr. Chairman.

Senator KING. Senator Sessions, closing?

Senator SESSIONS. Well, thank you, Mr. Chairman. You look good in that job.

[Laughter.]

Senator SESSIONS. A rapid rise, meteoric rise, I have to say.

Madam Chair, thank you for coming, and I know that you work hard at this job and take it exceedingly seriously. You were one of those more correct—the only one, I think, on the Board anticipating the severity of the housing crisis. So that is something that I express my appreciation for.

But just let me say we are not happy. The average American is not doing well. I do not think we need to overspin the positive numbers that are there, because I agree with Senator Portman almost totally on his comments about what he is hearing in the business world.

So thank you. You are challenged in your new position. We hope that you will lead us with wisdom and good insight. Thank you.

Ms. YELLEN. Thank you, Senator.

Senator KING. Chairman Yellen, thank you so much for joining us today. It has been delightful to meet you and to hear your, I think, very thoughtful comments. I want to thank my colleagues for the information.

My colleagues will meet back here on Tuesday, the 13th, for a hearing on expanding economic opportunity for women and families.

I also want to mention I was delighted, Chairman Yellen, to hear your comments about infrastructure. In 1832, a 23-year-old young man running for the legislature in Illinois talked about the key importance of infrastructure development—canals, riverways, and roads—for the development of the economy of the nascent United States. That was Abraham Lincoln at the age of 23.

Finally, as a reminder to my colleagues, additional statements and questions for the witness are due by 6:00 p.m. today to be submitted to the Office of the Chief Clerk in Room 624.

With that, and, again, our sincere thanks, Chairman Yellen, not only for appearing today but also for the work that you are doing.

Ms. YELLEN. Thank you so much.

Senator KING. I call this hearing to a close.

Ms. YELLEN. Thank you.

[Whereupon, at 11:27 a.m., the Committee was adjourned.]

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

JANET L. YELLEN
CHAIR

May 15, 2014

The Honorable Sheldon Whitehouse
United States Senate
Washington, D.C. 20510

Dear Senator:

Enclosed are my responses to the written questions you submitted following the May 8, 2014, hearing before the Senate Budget Committee. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I can be of further assistance.

Sincerely,

Janet L. Yellen

Enclosure

**<u>Questions for The Honorable Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System from Senator Whitehouse:</u>**

**1. Back in 1997 when you were Chair of the Council of Economic Advisors, you testified before the EPW Committee on climate change and said, "costs depend critically on how emission reduction policies are implemented. It boils down to this: if we do it dumb, it could cost a lot, but if we do it smart, it will cost much less and indeed could produce net benefits in the long run" Is it still your position that emissions reductions accomplished smartly can produce net benefits in the long run? Could a carbon fee under which the revenues were returned to the American people through spending programs or tax rate reductions produce net economic benefits?**

In my current role as chair of the Federal Reserve, I am fully absorbed in executing the important responsibilities assigned by the Congress to the Federal Reserve among them, the pursuit of price stability, maximum sustainable employment, financial stability, and the prudential regulation of financial institutions. Issues pertaining to the question of climate change are also important, but are best addressed by the Congress and the President.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

JANET L. YELLEN
CHAIR

June 13, 2014

The Honorable Jeff Sessions
United States Senate
Washington, D.C. 20510

Dear Senator:

Enclosed are my responses to the written questions you submitted following the May 8, 2014, hearing before the Senate Budget Committee. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I can be of further assistance.

Sincerely,

Janet L. Yellen

Enclosure

**<u>Questions for The Honorable Janet Yellen, Chair, Board of Governors of the Federal Reserve System from Senator Sessions</u>:**

**1. When the Federal Reserve holds risky assets on its balance sheet, there's a possibility that losses can occur when those assets are sold. The Federal Reserve created this possibility when it purchased $1.5 trillion mortgage backed securities and bonds, principally from Fannie Mae and Freddie Mac, that are not guaranteed by the federal government. In a note to its statistical release H 4.1, the Fed announced that losses stemming from these bonds would henceforth be a liability of the Treasury or of U.S. taxpayers.**

**Why may the Federal Reserve create liabilities for taxpayers without Congressional authorization to do so? Did the Fed create these liabilities when it purchased the non-guaranteed mortgage bonds of Fannie Mae and Freddie Mac and added these assets to the system's balance sheet?**

The Federal Open Market Committee (FOMC) is firmly committed to fulfilling its statutory mandate from the Congress of promoting maximum employment and price stability. In response to the recent financial crisis, economic recession, and the weak recovery that followed, the Federal Reserve has given the economy unprecedented support through large scale asset purchases (LSAPs) in an effort to put downward pressure on longer-term interest rates and ease financial conditions more broadly. Some of these purchases were in mortgage-backed securities issued and fully guaranteed by Fannie Mae and Freddie Mac. These purchases are consistent with the statutory authority governing Federal Reserve open market operations.

Once the economy improves sufficiently so that the effects of LSAPs are no longer needed, the FOMC will face issues of policy normalization. The Federal Reserve does not need to sell large volumes of its assets to normalize policy. Instead, balance sheet adjustment can occur gradually as existing securities mature over time. In particular, as noted in the June 2013 FOMC minutes, most participants anticipate that the FOMC will not sell agency mortgage-backed securities as part of the normalization process. As noted above, the FOMC conducts monetary policy at all times to foster its longer-term objectives of maximum employment and stable prices, and this principle will guide the process of normalizing the size and composition of the Federal Reserve's balance sheet.

It is important to note that the Federal Reserve is not exposed to any credit risk from its holdings of securities. The market value of the Federal Reserve's securities holdings—consisting almost entirely of Treasury securities and agency-backed mortgage-backed securities—is affected by the level of interest rates. However, any capital losses stemming from this sort of interest rate risk do not show through to Federal Reserve income unless the securities are sold. No losses are recorded for any security that is held to maturity. Even if the Federal Reserve were to sell some portion of its securities prior to maturity, capital losses would likely be modest and more than offset by positive interest earnings on its remaining securities holdings over the period affected by the LSAPs. For example, the Congressional Budget Office (CBO) recently projected that remittances from the Federal Reserve to the Department of Treasury (Treasury) will amount to about $484 billion from 2014 until the end of their projection period in 2024 (federal fiscal years, which run from October 1 to September 30), even with an assumption of some sales of longer-term securities and associated realized capital losses.[1] Moreover, Federal Reserve remittances to the Treasury from 2008-2013 were very large at about $400 billion. In short, the Federal Reserve's holdings of longer-term securities have already generated very sizable gains for U.S. taxpayers and will almost certainly continue to do so over coming years.

**2. Your testimony before the Senate's Committee on the Budget contained your claim that the overall decline in the rate of labor force participation that has occurred since the end of the 2008-2009 recession is due in a part to the retirement of "baby boomers" and, thus, their departure from the labor force as they age. This claim is disputed by many labor economists who suggest that the rates of participation for older workers have increased since 2009 and that retirements have been offset by young people entering the labor force.**

**Please provide the evidence and research behind your claim or a correction. Furthermore, include in that production the change in the rates of labor force participation by age intervals (preferably 5-year intervals) for each year from (and including) 2009 to the most recent available data.**

As indicated in my testimony, I believe that some of the decline in the aggregate labor force participation rate since the recession reflects the aging of the "baby boomers" and their departure from the labor force as they retire. In particular, while it is true that labor force participation rates have been rising for older individuals, the average rate of participation among those ages 65 and over is still only about 19 percent, well below the average participation rate of 62.8 percent for the entire working-age population. As a result of this substantial drop-off in labor force attachment at older ages, the movement of the large baby-boom cohort into their retirement years is putting downward pressure on the aggregate participation rate.

The attached table provides the data you requested. In addition, you will find an attached chart that shows a decomposition of the cumulative change in the aggregate labor participation rate since 2008 into the part due to the aging of the population and the part due to changes in age-specific participation rates. As indicated by the striped blue bar in the last column on the right, the aging of the population accounts for about 1 percentage point of the 2¾ percentage point decline in the aggregate participation rate since 2008; thus, according to this calculation, the aging of the population has accounted for more than one-third of the decline in the aggregate labor force participation rate since 2008. Declines in the participation rates of young people (ages 16-24) and prime-age individuals (ages 25-54) each contribute a little less than 1 percentage point to the decline, while the increases in participation rates among those 55 and older have added only about ¼ percentage point to the aggregate participate rate since 2008.

[1] See "The Budget and Economic Outlook: 2014 to 2024" released by the CBO in April 2014. Also, see Carpenter et al. (2013), "The Federal Reserve's Balance Sheet and Earnings: A Primer and Projections," Finance and Economics Discussion Papers 2013-01, Board of Governors of the Federal Reserve System (U.S.), for additional projections of Federal Reserve income associated different interest rate assumptions and exit strategies.

**3. Your Budget Committee testimony contains the statement that the federal funds rate is your "...traditional policy tool." As you have noted elsewhere, this rate is the principal tool used by the Open Market Committee to affect the demand for credit and credit's price. The direction of the federal funds rate, up or down, presumably anticipates a similar movement in the same direction of other key market interest rates. That said, you also noted in answers to questions by Committee members that the key rates for mortgages and for Treasury bonds are increasing despite the federal funds rate being near zero since late 2008. Indeed, the increase in mortgage interest rates is one reason you mentioned for the slowdown in housing demand that you raised as a caution to your otherwise generally optimistic view of the near-term economic outlook.**

**What does the evidence say about the degree of direct control that the Federal Reserve has over market interest rates (both short and long-term)?**

Historically, the Federal Reserve has been able to exert tight control over the level of the overnight federal funds rate by adjusting the supply of reserve balances on a regular basis to meet the expected demand for reserves at the FOMC's target federal funds rate. Apart from small idiosyncratic fluctuations, arbitrage by investors generally ensures that other short-term interest rates, such as Treasury bill yields, commercial paper rates, and repo rates, typically move closely with the level of the federal funds rate. As noted in the minutes of recent FOMC meetings, even in the current environment with extraordinarily elevated levels of excess reserves, the Federal Reserve is confident that it will be able to use a range of policy tools, including interest on reserves along with overnight and term reserve draining tools to put upward pressure on short-term interest rates and remove policy accommodation at the appropriate time.

The Federal Reserve's control over *longer-term interest rates* is more indirect and more limited than its influence over the level of the federal funds rate. Longer-term interest rates can be viewed as the sum of the expected average level of short-term interest rates over the maturity of the instrument and a "term premium" that accounts for the increased risk of longer-term investments. The first component importantly reflects investors' views about the economic outlook and how the Federal Reserve will adjust the level of the federal funds rate in response to changes in that outlook. Especially in the current environment, the Federal Reserve has provided greater clarity about the likely future path of short-term interest rates through various communications including FOMC statements and minutes, my post-meeting press conferences, and the quarterly Summary of Economic Projections.

The second component—the term premium—reflects many factors including uncertainties regarding the future course of the economy and of interest rates, changes in investors' willingness to bear risk, and changes in the aggregate supply of longer-term securities. Over recent years, the Federal Reserve has conducted large scale asset purchases of longer-term Treasury and MBS securities to put downward pressure on longer-term interest rates. Large scale asset purchases put downward pressure on long-term interest rates primarily by reducing the term premium.

The backup in longer-term interest rates witnessed over the past year or so seems to reflect a rise in both the expected future path of short-term rates and the term premium. In large part, the rise in the expected future path of policy appears to reflect the improvement in the economic outlook. Since last May, for example, the unemployment rate has declined from 7.5 to 6.3 percent. A portion of the rise in the term premium over the past year may also be related to the improvement in economic outlook. As the outlook has improved, investors anticipated some scaling back in the pace of the Federal Reserve's asset purchases and this likely put a little upward pressure on long-term rates. However, as noted above, the term premium embedded in long-term rates is affected by many factors. Over the summer of 2013, for example, many reports suggested that some investors had taken large positions in fixed income market that were premised on unrealistic expectations about Federal Reserve policy and the level of volatility in financial markets. The unwinding of these expectations contributed importantly to the substantial rise in long-term rates last year.

On balance, we have not seen convincing evidence to date suggesting that the short-run effect of monetary policy on long-term interest rates is diminished relative to that in the past. That said, long-term interest rates are volatile, and there will almost surely be future episodes in which long-term rates move up or down in ways that are difficult to reconcile with the economic outlook or the stance of monetary policy. For its part, as always, the Federal Reserve will strive to communicate its economic and policy outlook clearly so that investors can anticipate the likely future path of short-term rates. Of course, over the long run, the Federal Reserve exerts its strongest influence over the level of long-term interest rates through its commitment to foster maximum employment and price stability.

**4. Your responses to several questions on the long-term fiscal outlook underscored your concern about rising deficits and rapidly accumulating debt. Indeed, you stated your view that debt increases as predicted by CBO would slow the economy and lead to an unsustainable fiscal situation.**

**Given those views as expressed in today's hearing, would balancing our budget over 10 years improve the long-term economic outlook? At what stage of the economic cycle is it appropriate to begin a process of fiscal consolidation?**

Significant progress has been made in recent years toward reducing the federal budget deficit. The federal deficit was about 4 percent of nominal gross domestic product (GDP) last fiscal year, and the CBO estimates that the deficit this year will be below 3 percent of GDP. The federal deficit is now much smaller than its recent peak of almost 10 percent of GDP in fiscal year 2009, with this reduction reflecting both the budgetary effects of the economic recovery over the past five years along with fiscal policy actions taken to reduce federal spending and increase taxes. Although fiscal policy actions have helped reduce the budget deficit in the near term, this fiscal restraint has slowed the pace of the economic recovery. The CBO estimates that deficit-reduction policies reduced the rate of real GDP growth by roughly 1½ percentage point last year and will lower economic growth by about ¼ percentage point this year, relative to what it would have been otherwise.

Even with the progress made in shrinking near-term budget deficits, little has been done to address the projected longer-run imbalances in the federal government's budget. If current federal budget policies do not change, the CBO projects that the further aging of the population, rising health care costs, and growing interest payments on federal debt will all contribute importantly to rising budget deficits after next year. To promote economic growth and stability in the longer term, it will be essential for fiscal policymakers to put the federal budget on a sustainable long-run path. However, since our economy is not yet back to full employment, it would be appropriate to not impose additional near-term fiscal restraint. Nevertheless, fiscal policymakers could put in place now a credible plan to set fiscal policy on a sustainable path in the longer run while not restraining the economic recovery in the short run.

**5. In December of 2013, the 10-year Treasury note rate rose to level over 3 percent. It has now fallen to under 2.6 percent. Is that a negative indication for long-term economic growth?**

Between December 31, 2013 and May 16, 2014, the 10-year Treasury yield declined by more than ½ percentage point, from 3.08 percent to 2.54 percent. Shorter-dated Treasury yields declined substantially less over this period; for example, the 5-year Treasury yield declined by only 17 basis points, from 1.74 percent to 1.57 percent. Thus, the decline in the 10-year Treasury yield reflects an even larger decline in long-term forward rates; by contrast, expectations of lower policy rates in the near-term appear to play only a minor role. It is worth noting that, over this period, 10-year government bond yields in several advanced foreign economies, notably Canada, the United Kingdom, and Germany, have declined by amounts similar to the decline in the 10-year Treasury yield.

Long-term forward rates are quite volatile and often difficult to explain in terms of economic fundamentals. The sharp decline in long-term forward rates early last year and the subsequent reversal over the summer are a case in point. In principle, a decline in long-term forward rates could reflect a decline in expected future real short-term interest rates, expected future inflation, or the term premium, perhaps because of reduced uncertainty about the future course of the economy and of interest rates. If market participants expect a lower pace of longer-term economic growth, this would be primarily reflected in a lower level of expected real interest rates.

Market participants have pointed to a variety of factors that might have contributed to a decline in long-term forward rates this year, including a decline in uncertainty about long-term rates, reports of increased demand for long-duration assets by some investors, and perhaps also changes in forward guidance that have provided more information about the post liftoff policy path. In the Survey of Primary Dealers conducted by the Federal Reserve Bank of New York prior to the April 2014 FOMC meeting, dealers were asked to decompose the decline in long-horizon forward rates since the end of 2013 into expected real rates, expected inflation, and term premiums. On average, these dealers assigned about half of the decline to reduced term premiums, and a little more than a quarter to lower future real short-term interest rates. Thus, it is likely that expectations of lower long-term economic growth contributed only modestly to the decline in longer-term Treasury yields since the beginning of the year. Such an interpretation seems also consistent with the fact that broad stock prices are up a little since the end of last year and credit spreads have narrowed a touch. A significant decline in long-run growth expectations might have been expected to depress stock prices and boost risk spreads.

**Annual change in labor force participation rates by age group**

| | 2009/ 2008 | 2010/ 2009 | 2011/ 2010 | 2012/ 2011 | 2013/ 2012 |
|---|---|---|---|---|---|
| Overall LFPR | -0.62 | -0.69 | -0.60 | -0.41 | -0.45 |
| 16 - 19 | -2.67 | -2.55 | -0.80 | 0.14 | 0.18 |
| 20 - 24 | -1.40 | -1.54 | -0.12 | -0.35 | -0.21 |
| 25 - 29 | -0.97 | -0.12 | -0.85 | 0.16 | -0.73 |
| 30 - 34 | -0.36 | -0.88 | -0.45 | 0.11 | -0.16 |
| 35 - 39 | -0.22 | -0.53 | -0.62 | -0.17 | -0.16 |
| 40 - 44 | -0.59 | -0.37 | -0.47 | -0.06 | -0.57 |
| 45 - 49 | -0.44 | -0.32 | -0.42 | -0.43 | -0.58 |
| 50 - 54 | -0.11 | -0.51 | -0.59 | -0.39 | -0.43 |
| 55 - 59 | 0.00 | 0.21 | -0.47 | -0.37 | -0.03 |
| 60 - 64 | 1.09 | 0.04 | -0.67 | 0.73 | -0.25 |
| 65 - 69 | 0.43 | 0.32 | 0.65 | -0.02 | 0.07 |
| 70 - 74 | 0.65 | -0.42 | 0.82 | 0.64 | -0.25 |
| 75+ | -0.00 | 0.08 | 0.10 | 0.13 | 0.31 |
| Memo: | | | | | |
| 25 - 54 | -0.46 | -0.46 | -0.57 | -0.14 | -0.44 |
| 55 - 64 | 0.38 | 0.01 | -0.67 | 0.23 | -0.12 |
| 65+ | 0.40 | 0.16 | 0.54 | 0.56 | 0.24 |

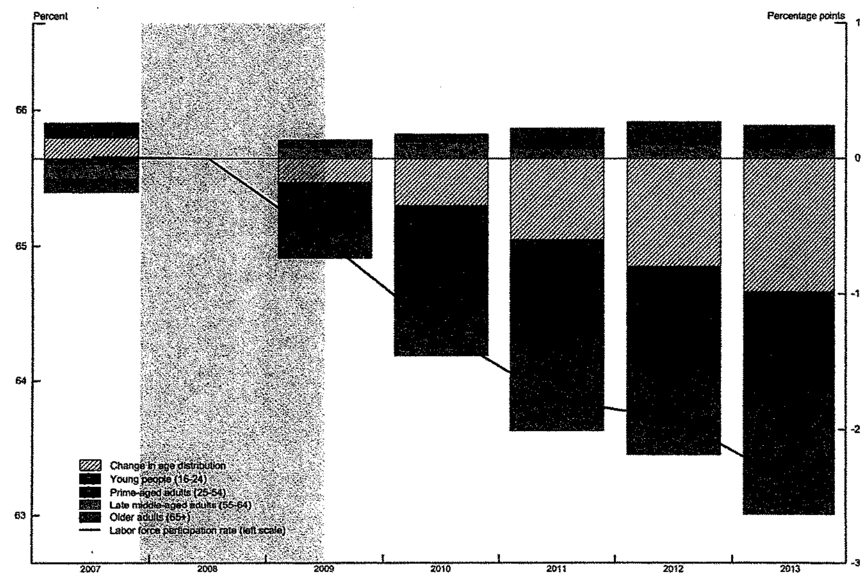
Source: Current Population Survey, Bureau of Labor Statistics.

**Cumulative change since 2008 in labor force participation rates by age group**

| | 2009/ 2008 | 2010/ 2008 | 2011/ 2008 | 2012/ 2008 | 2013/ 2008 |
|---|---|---|---|---|---|
| Overall LFPR | -0.62 | -1.30 | -1.90 | -2.31 | -2.76 |
| 16 - 19 | -2.67 | -5.22 | -6.02 | -5.88 | -5.70 |
| 20 - 24 | -1.40 | -2.95 | -3.07 | -3.42 | -3.63 |
| 25 - 29 | -0.97 | -1.09 | -1.94 | -1.77 | -2.51 |
| 30 - 34 | -0.36 | -1.25 | -1.70 | -1.59 | -1.75 |
| 35 - 39 | -0.22 | -0.75 | -1.37 | -1.54 | -1.69 |
| 40 - 44 | -0.59 | -0.96 | -1.43 | -1.50 | -2.06 |
| 45 - 49 | -0.44 | -0.75 | -1.17 | -1.60 | -2.18 |
| 50 - 54 | -0.11 | -0.62 | -1.22 | -1.60 | -2.03 |
| 55 - 59 | 0.00 | 0.21 | -0.26 | -0.63 | -0.66 |
| 60 - 64 | 1.09 | 1.13 | 0.46 | 1.18 | 0.94 |
| 65 - 69 | 0.43 | 0.76 | 1.40 | 1.39 | 1.46 |
| 70 - 74 | 0.65 | 0.23 | 1.06 | 1.70 | 1.45 |
| 75+ | -0.00 | 0.08 | 0.18 | 0.31 | 0.62 |
| Memo: | | | | | |
| 25 - 54 | -0.46 | -0.92 | -1.50 | -1.63 | -2.08 |
| 55 - 64 | 0.38 | 0.38 | -0.29 | -0.05 | -0.17 |
| 65+ | 0.40 | 0.56 | 1.10 | 1.66 | 1.90 |

Source: Current Population Survey, Bureau of Labor Statistics.

**Contributions to change in labor force participation rate since 2008**




Source: Current Population Survey microdata. Data are adjusted for revisions to population controls.