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THE CONGRESSIONAL BUDGET OFFICE'S BUDGET AND ECONOMIC OUTLOOK

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

HEARING HELD IN WASHINGTON, DC, FEBRUARY 1, 2012

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THE CONGRESSIONAL BUDGET OFFICE'S BUDGET AND ECONOMIC OUTLOOK

WEDNESDAY, FEBRUARY 1, 2012

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

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

Present: Representatives Ryan, Garrett, Campbell, McClintock, Stutzman, Lankford, Black, Ribble, Flores, Mulvaney, Huelskamp, Young, Amash, Rokita, Woodall, Van Hollen, Doggett, Blumenauer, McCollum, Yarmuth, Pascrell, Honda, Ryan of Ohio, Moore, Castor, Tonko, Bass.

Chairman RYAN. The Committee will come to order. Welcome all to this very important hearing on the difficult fiscal challenges and economic challenges ahead of us. I want to welcome the CBO director back with us again with his beautiful daughters. It is good to have you here again, Doug, I wish we had better news.

I want to thank Doug, first of all, Dr. Elmendorf and your entire CBO staff for the hard work on the release of the annual budget and economic outlook. We have a compressed timeline this year, given the tardiness of the president's budget, given our Easter coming earlier; so we know that CBO was going to be pushed extra hard this year, and I know you are working really hard around the clock over there. So first off I want to start by saying thank you for all you have done.

There is no question about it; our fiscal and economic outlook is grim. According to CBO's outlook, 2012 will mark the fourth straight year of trillion dollar deficits. Trillions more dollars will be added to the debt in the years ahead, putting a chilling effect on job creation today and committing the next generation to a diminished future. CBO projects economic growth will remain sluggish and the unemployment rate to hover near 9 percent through 2014. This report confirms what too many Americans already painfully are aware of: President Obama's economic policies simply are not working.

The president and his party's leaders successfully enacted much of their agenda, but they have failed to advance policies that get our economy growing. They have failed to advance solutions that get our fiscal house in order. In the Senate, they have failed to pass a budget in over 1,000 days. The problems have been growing for years, and there is no question that the blame is bipartisan in nature. For years politicians from both political parties have failed

to be honest with the American people about the size and scope of this debt threat. The new House majority has worked to chart a new course.

In this committee, we authored and advanced a principled reform agenda that provides a brighter fiscal and economic outlook. The House passed budget strengthens our critical health and retirement security programs, it repairs our fraying safety net, and it makes sensible reforms that spur job creation and economic growth, while putting government spending on a more sustainable path.

In response to our budget, the president and his party leaders have still yet to put forward a credible plan to solve our country's problems. Look, we have a big difference of opinion on the big questions of the day, but I hope CBO's alarming report encourages us to focus on the urgent need for real solutions instead of resorting to the same old false attacks with no alternatives.

Let's build upon the sensible spending cuts enacted last year in a bipartisan basis. Here at the House Budget Committee, we have worked in a bipartisan manner to advance budget reforms aimed at reducing the deficit and improving accountability. There are ongoing efforts to build a bipartisan coalition on the critical need to save and shrink in Medicare, for example. I invite the president and my friends across the aisle to join us in this conversation. The CBO's outlook could not be more ominous. I look forward to your testimony, Dr. Elmendorf, which I hope can inform and guide this committee as we work to advance solutions in the year head, and with that I will yield to the ranking member Mr. Van Hollen.

[The prepared statement of Chairman Paul Ryan follows:]

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

Welcome all to this important hearing on the difficult fiscal and economic challenges before us.

I welcome Congressional Budget Office Director Doug Elmendorf to the Budget Committee. I thank you Doug and your entire CBO staff for their hard work on the release of the annual Budget and Economic Outlook.

There is no question about it: The outlook is grim.

According to CBO's outlook, 2012 will mark the fourth straight year of trillion-dollar deficits. Trillions more dollars will be added to the debt in the years ahead, putting a chilling effect on job creation today, and committing the next generation to a diminished future. CBO projects economic growth to remain sluggish and the unemployment rate to hover near 9 percent through 2014.

This report confirms what too many Americans are already painfully aware of: President Obama's economic policies are not working.

The President and his party's leaders successfully enacted much of their agenda, but they have failed to advance policies that get our economy growing and creating jobs. They have failed to advance solutions that get our fiscal house in order. In the Senate, they have failed to pass a budget in over 1,000 days.

The problems have been growing for years, and there is no question that the blame is bipartisan in nature. For years, politicians from both political parties have failed to be honest with the American people about the size and scope of the debt threat.

The new House Majority has worked to chart a new course with bold solutions. In this committee, we authored and advanced a principled reform agenda that provides a brighter fiscal and economic outlook. The House-passed budget strengthens our critical health and retirement security programs, repairs the safety net, reforms the broken tax code, and puts government spending on a sustainable path.

In response to our budget, the President and his party's leaders have still not put forward a credible budget plan to tackle our problems.

We have big differences of opinion on the big questions of the day, but it is not enough to simply criticize. It is not simply enough to oppose—we need to propose real solutions instead of resorting to the same old false attacks.

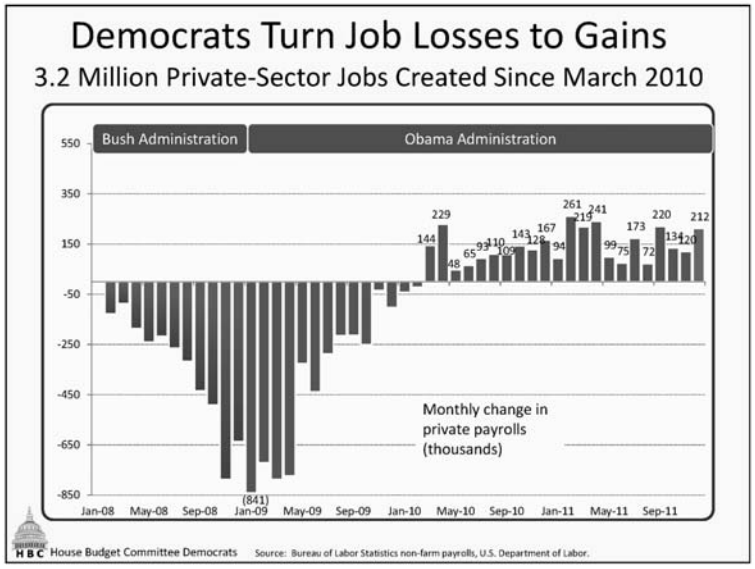
Here at the Budget Committee, we've worked in a bipartisan manner to advance budget reforms aimed at reducing the deficit and improving accountability. There are ongoing efforts to build a bipartisan coalition on the critical need to save and strengthen Medicare. I invite the President and my friends across the aisle to join this conversation.

The CBO's Outlook could not be more ominous. I look forward to your testimony, Director Elmendorf, which I hope can help inform and guide this committee as we work to advance solutions in the year ahead.

With that, I yield to Ranking Member, Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman, I want to join the chairman in welcoming you, Dr. Elmendorf, and your two daughters. It is great to have members of the family here today, and I want to reference the report that was issued by CBO yesterday that the chairman mentioned because while it shows that the economy remains very fragile, it also shows that it is slowly recovering; it demonstrates that we still have much work to do to create jobs, tackle the deficit and return the budget to a long-term fiscally sustainable path.

For a moment let's focus on the positive signs of the budding economic recovery, and remember where we were just three years ago. If you could please put up the first slide.



What this slide shows is the day that President Bush left office, the day that President Obama was sworn in, the economy was collapsing at an even faster rate than originally thought. The gross domestic product was plummeting at a rate of 8.9 percent, in other words, negative 8.9 percent GDP, and we were shedding more than 840,000 jobs a month; so in the month the president was sworn in, 840,000 jobs were lost.

As shown in previous CBO reports and findings, the passage of the Recovery Act, coupled with actions to save the auto industry and efforts by the Federal Reserve, helped end the free fall, and

began the climb upward toward economic growth. Now we have all heard the expression that we are entitled to our own opinions, but not our own facts. The fact is that the CBO said that the Recovery Act helped save, or create, up to 3 million jobs in the year 2010, that it lowered the unemployment rate by up 1.8 percentage points in calendar year 2010, and lowered unemployment by up to 1.4 percentage points in 2011, compared to what it would have done if the Congress had not taken action.

The private sector has now added jobs in every month since March 2010, adding 3.2 million jobs in total. More jobs were created last year than in any year since 2005. What this chart shows, very plainly, is that we were on a huge downhill cascade. After the president was sworn in we began to reduce the downward momentum, turn the corner, and we have been steadily heading up, first reducing the rate of job loss, which you obviously have to do when you are losing GDP at a 8.9 percent rate, and headed into positive job territory. So the facts as reported by the CBO are clear that the Recovery Act did serve its purpose. It is kind of like when you are walking up an escalator that is going down very quickly. If you take no action, you will go down very fast. Even if you take action, it will appear at first that you are running in place, and then slowly you will be moving up, and that is what we are doing.

The CBO report, of course, also shows that the economy remains fragile and that we still face serious budget obstacles. While the economy continues to grow, at the current rate it will take too long for unemployment to return to the pre-crisis levels, which is why our first priority has to be making sure we do what we can to help small businesses and businesses help put people back to work.

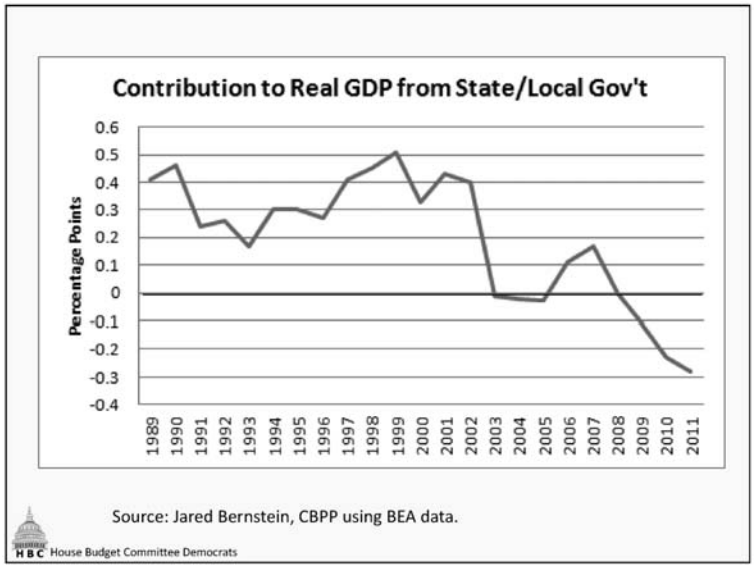
We should take immediate action in this House on the plan the president submitted to the Congress last September. The president's jobs plan, including his significant infrastructure investments to help rebuild our infrastructure around the country. We should finish the job with respect to extending the payroll tax cut for 160 million Americans, and making sure that unemployment insurance is there for people who have lost work through no fault of their own.

Mr. Chairman, I am going to apologize to both you and Dr. Elmendorf because after the statement I am going to have to go to the Conference Committee on that issue, and I hope that Conference Committee will move forward quickly and without delay to get that job done.

Finally, the Congressional Budget Office's report underscores the need to address the looming deficit in a balanced, reasoned way. The Budget Control Act that this body passed last year and the president signed saves about $1 trillion from cuts in the discretionary budget over the next decade. It will also result in an additional $1 trillion in deficit reductions starting in January 2013. There are better ways to do that and there are worse ways to do that; I hope this Congress will come together and do it in a way that makes sense.

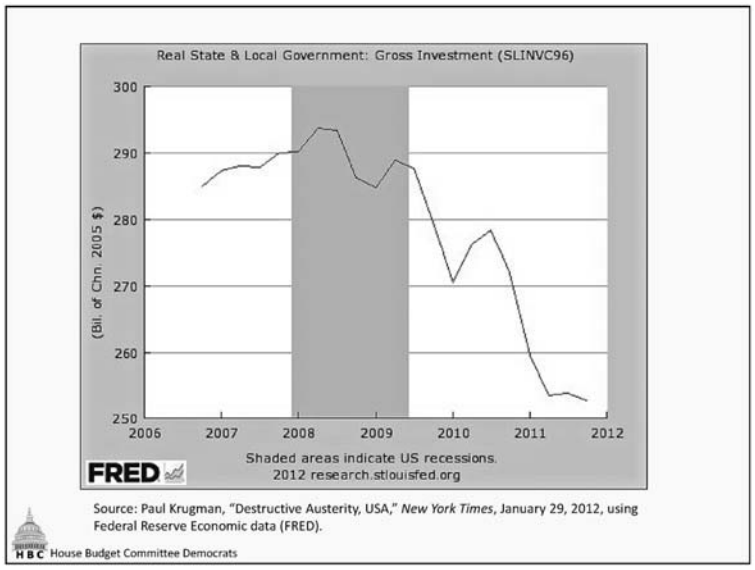
I think as we listen to the testimony from Dr. Elmendorf, it will be clear that the bipartisan commission s that have looked at this challenge were right: Simpson-Bowles, Rivlin-Domenici, that you really need to tackle this in a balanced way. I am just going to

quickly put up two charts and then I will conclude my opening statement.



What this chart shows, and I believe, Dr. Elmendorf, it is in your testimony, is that under current law the deficit would be reduced to that bottom heavily blue shaded line so that over the 10 year period the deficit would decline substantially. If we packed our bags and went away and did not come back until next year, it would reduce the deficit significantly. That very lightly shaded blue right over the bottom bar is the revenue that is lost if we keep in place all the current tax policies, and so clearly that is a factor. Now, I do not think anyone is suggesting that we want to put in policies that would capture all that revenue; I am not suggesting that, but this is an important chart to understand what current law would do in the impact of revenue.

If we go to the next chart, it quantifies those numbers and makes it clear that if you extend all the 2001, 2003 tax cuts in index AMT, that adds 4.5 trillion to the deficit.



The other tax extenders, if you continue those, it adds $839 billion. If you add the debt service on that you get to over $6.3 trillion in revenue; and if you look at the CBO baseline deficits, cumulative over 10 years, they are just over 3 trillion. So the cost of continuing all those policies on the revenue side leads to a doubling of the deficit over the next 10 years.

I want to make it clear: I am not proposing that we change all the current policies, but I think this does give us a very clear indication of the order of magnitude. I will give a very clear example. One trillion of that is accounted for by the tax cuts for the folks at the very top, and if you returned those tax rates to where they were during the Clinton administration, a period of great economic growth, that would be $1 trillion of that. I think we need to tackle this through tax reform, closing loopholes, sensible tax reform, but I do think this underscores what the bipartisan groups have said, that you need to take a balanced approach; yes we need to make some cuts, we need to make some reforms, but we also need to deal with the other side of the equation as well. Thank you, Mr. Chairman, and I apologize for having to leave.

[The prepared statement of Chris Van Hollen follows:]

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

Thank you, Mr. Chairman. I want to join the Chairman in welcoming you, Dr. Elmendorf, and your two daughters; it's great to have members of the family here today. And I want to reference the report that was issued by CBO yesterday, because while it shows that the economy remains very fragile, it also shows that it is slowly recovering. It demonstrates that we still have much work to do to create jobs, tackle the deficit, and return the budget to a long-term fiscally sustainable path. But for a moment, let's focus on the positive signs of the budding economic recovery and remember where we were just three years ago.

The day that President Bush left office, the day that President Obama was sworn in, the economy was collapsing at an even faster rate than originally thought. The gross domestic product was plummeting at a rate of 8.9 percent, in other words negative 8.9 percent GDP, and we were shedding more than 840,000 jobs a month. So

in the month the President was sworn in, 840,000 jobs were lost. As shown in previous CBO reports and findings, the passage of the Recovery Act—coupled with actions to save the auto industry and efforts by the Federal Reserve—helped end the free fall and began the climb upward toward economic growth.

Now, we've all heard the expression that we're entitled to our own opinions, but not to our own facts. The fact is that the CBO said that the Recovery Act helped save or create up to 3 million jobs in the year 2010. It also lowered the unemployment rate by up to 1.8 percentage points in calendar year 2010, and lowered unemployment by up to 1.4 percentage points in 2011, compared to what it would have done if the Congress had not taken action. The private sector has now added jobs in every month since March 2010, adding 3.2 million jobs in total. More jobs were created last year than in any year since 2005. It is clear that we were on a huge downhill cascade and that after the President was sworn in, and we began to reduce the downward momentum and turn the corner. We have been steadily heading up, reducing first the rate of job loss, which you obviously have to do when you're losing GDP at an 8.9 percent rate, and now heading into positive job territory.

So, the facts as reported by the CBO are clear that the Recovery Act did serve its purpose. It's kind of like when you're walking up an escalator that's going down very quickly. If you take no action, you will go down very fast. Even if you take action, it will appear at first that you're running in place and then slowly you'll be moving up. That's what we're doing.

The CBO report, of course, also shows that the economy remains fragile and that we still face serious budget obstacles. While the economy continues to grow at the current rate, it will take too long for unemployment to return to the pre-crisis levels. That is why our first priority has to be making sure we do what we can to help small business and businesses help put people back to work. We should take immediate action in this House on the jobs plan the President submitted to the Congress last September, including his significant infrastructure investments to help rebuild our infrastructure around the country.

We should also finish the job with respect to extending the payroll tax cut for 160 million Americans and making sure that unemployment insurance is there for people who have lost work through no fault of their own. And, Mr. Chairman, I'm going to apologize to both you and Dr. Elmendorf, because after this statement I'm going to have to go to the conference committee on that issue and I hope that conference committee will move forward quickly and without delay to get that job done.

Finally, the Congressional Budget Office's report underscores the need to address the looming deficit in a balanced, reasoned way. The Budget Control Act that this body passed last year and the President signed saves about $1 trillion from cuts in the discretionary budget over the next decade. It will also result in an additional $1 trillion in deficit reductions starting in January 2013. There are better ways to make those additional cuts; I hope this Congress will come together and do it in a way that makes sense. But I think as we listen to the testimony from Dr. Elmendorf, it will be clear that the bipartisan commissions that have looked at this challenge—both Simpson-Bowles and Rivlin-Domenici—were right that you really need to tackle this in a balanced way.

Under current law, if we packed our bags—and didn't come back until next year, it would reduce the deficit significantly. And we would lose significant revenue if we keep in place all the current tax policies, and so clearly that is a factor. Now, I don't think anyone is suggesting that we want to put in policies that would capture all that revenue; I'm not suggesting that. But it is important to understand how big an impact those projected revenues have on CBO's deficit estimates.

If you extend all the 2001, 2003 tax cuts and index AMT, that adds $4.5 trillion to the deficit. And if you continue other tax extenders, it adds $839 billion. If you add the debt service on that, you get to over $6.3 trillion added to the deficit. Now, if you look at the CBO baseline deficits, cumulative over ten years, they're just over $3 trillion. So the cost of continuing all those policies on the revenue side leads to a doubling of the deficit over the next ten years. So I want to make it clear, I am not proposing that we change all the current policies, but I think this does give us a very clear indication of the order of magnitude. I'll give a very clear example. If you returned the tax rates for the folks at the very top to where they were during the Clinton administration, a period of great economic growth, we could reduce our deficit by about $1 trillion.

This report underscores what the bipartisan groups have said—you need to take a balanced approach. Yes, we need to make some cuts, we need to make some reforms, but we also need to deal with the other side of the equation as well. I think we need to tackle this by also closing loopholes and enacting sensible tax reform.

Thank you, Mr. Chairman, and I apologize for having to leave.

Chairman RYAN. Sure, my pleasure. Dr. Elmendorf, the time is yours.

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

Mr. ELMENDORF. Thank you, Mr. Chairman and Congressman Van Hollen. Thank you for your kind words about CBO. I am privileged to be leading a group of extraordinarily talented and dedicated public servants, and we all appreciate it very much this support that you, Mr. Chairman, and you, Congressman Van Hollen, have shown for our work. We will continue to do our very best for this committee and for the Congress as a whole.

I will be referring, as I talk, to some charts that I am told are in your notebooks. It is about half a dozen slides. They are mostly out of the outlook, but they are collected in this little handout to makes it easier for you to follow what I say.

Let me begin by noting that our baseline economic and budgetary projections are conditioned on current law, not because we expect that there will be no changes in law, but because this approach provides a benchmark against which potential changes can be measured. What we are presenting is a benchmark, not a forecast. That distinction has a large impact on the budget and economic projections.

What is our assessment of the economic outlook? As you know, the pace of the recovery has been slow since the recession ended two and a half years ago, and we project that it will continue to be slow for the next two years, reflecting both the lingering effects of the crisis in the financial markets and the recession, and the fiscal restraint that will arise under current law. Specifically, current law fiscal policy will reduce the growth of output slightly in 2012 and significantly in 2013 through a combination of large tax increases and spending cuts. Our projections incorporate the upcoming expiration of the payroll tax cut and emergency unemployment benefits, the expiration of the tax cuts enacted in 2001, 2003, and 2009, as well as other expiring tax provisions.

The constraints on spending imposed by last year's Budget Control Act and the winding down of the budgetary effects of the 2009 Recovery Act. Taken together those policies will generate a sharp fiscal contraction. In addition, the excess number of houses, loss of wealth, run-up in debt, and other legacies of the economic downturn are continuing to weigh on household and business spending.

If you look at the first slide in the packet which looks roughly like this, we project that real GDP will grow by only two percent this year and only about one percent next year. We expect economic activity to quicken after 2013, but real GDP to remain below the economy's potential through 2017.

According to our projections, the economy is only about halfway through the cumulative shortfall in output that will result from the recession and its aftermath. This picture is not the one to which I am referring at the moment. The costs associated with that persistent output gap are immense and they fall disproportionately on people who lose their jobs, who are displaced from their homes, or who own businesses that fail. In particular, the labor market still

has a great deal of slack, mainly as a consequence of continued weakness in demand for goods and services.

In CBO's forecast, unemployment rate remains above eight percent, both this year and next. As economic growth picks up after 2013, the unemployment rate will gradually decline, but in our projection it remains above 7 percent until 2015 before dropping to 5 and one-quarter percent by the end of the coming decade. While the economy continues to be weak during the next few years, inflation and interest rates will remain low. Let me turn now to our budget projections.

Under current law we expect that this year's deficit will be about $1.1 trillion. At 7 percent of GDP, that is nearly 2 percentage points less than the deficit recorded last year, but still larger than any deficit between 1947 and 2008. Over the next few years projected deficits in CBO's baseline narrow sharply, averaging one and a half percent of GDP and totaling about $3 trillion between 2013 and 2022.

With deficits small relative to the size of the economy, debt held by the public drops a little as a share of GDP, but remains quite high. Much of the projected decline in the deficit occurs because under current law revenues will rise considerably. In particular, between 2012 and 2014, revenues in our baseline shoot up by more than 30 percent because of the recent or scheduled expiration of various tax provisions, and new taxes and other collections that are scheduled to go into effect. Federal spending on the baseline declines modestly relative to GDP in the next few years as the economy expands and the statutory caps constrain discretionary appropriations.

Later in the decade, spending turns up again relative to GDP because of increasing expenses generated by the ageing of the population, rising costs for health care, and because the accumulation of debt and rising interest rates will cause a surge in the government's interest costs.

Of course, these baseline projections are heavily influenced by the changes in tax and spending policies that are embodied in current law; changes, that in some cases, represent a significant departure from recent policies.

To illustrate the budgetary consequences of maintaining some tax and spending policies that have recently been in effect, CBO developed projections under an alternative fiscal scenario. Like the baseline, this is not a prediction by us about policy or a recommendation about policy, it is simply meant to show to you the consequences of some fiscal actions that are regularly discussed in the Congress. This alternative scenario incorporates the following assumptions.

First, that all expiring tax provisions other than the payroll tax reduction are extended.

Second, that the alternative minimum tax or AMT is indexed for inflation after 2011.

Third, that Medicare's payment rates for physician's services are held constant at their current level, rather than dropping by 27 percent in March and more thereafter as scheduled under current law; and fourth, that the automatic spending reductions required by the Budget Control Act, in the absence of legislation reported

by the join select committee on deficit reduction, do not take effect; although, in this scenario the original caps on discretionary appropriations would remain in place.

Under that alternative fiscal scenario, deficits over the 2013, 2022 period would be far higher than in the baseline, averaging five and a half percent of GDP rather than one and a half percent, and totaling $11 trillion, rather than roughly $3 trillion.

Debt held by the public would climb on an unsustainable path, reaching 94 percent of GDP in 2022, the highest figure since just after World War II. Under that scenario, the economy would be noticeably stronger during the next few years than under current law, but noticeably weaker later in the decade. The report presents estimates of those effects using ranges of numbers to reflect the uncertainty involved. The midpoints of the ranges for the end of 2013 show GNP, that is two percent higher, and an unemployment rate that is 1 percentage point lower than would be the case under current law. However, the midpoint of the range for 2022 shows GNP that is almost two and a half percent lower than under current law because of the crowding out of investment that would be caused by the escalating debt.

It bears emphasis that projecting economic outcomes for any path of fiscal policy, and the budget outcomes that would result from them, is very difficult. Many things could turn out to cause the economy and the budget to be worse or better than we project; however, there is no plausible economic outcome under which the policies of the alternative scenario I have outlined would lead to a sustainable budget outcome.

The fundamental fiscal challenge, during this decade and beyond, remains the aging of the population and rising costs for health care. The number of people aged 65 or older will increase by one-third in the coming decade, substantially raising the cost of Social Security, Medicare, and Medicaid. In addition, the Affordable Care Act will significantly increase the number of non-elderly people receiving assistance through federal health care programs.

Furthermore, CBO predicts that the cost per enrollee for Social Security and the major health care programs will continue to rise. Because of these forces the stated budget policies that were in effect in the past cannot be maintained in the future.

Here is one way to think about the problem using CBO's projections under the alternative fiscal scenario, which as I have said, represents a combination of many recent and current policies. Under this scenario, outlays for Social Security and the health care programs would be much higher by the end of this coming decade than in the past, more than 5 percent of GDP higher than in that 40 year average. However, outlays for all other federal programs are projected to be much lower than in the past, averaging in the past 40 years, they have averaged about 11 percent of GDP. In our projections for this scenario they would be about 8 percent of GDP in 2022. That would be lower than any year in the past 40 years.

Despite the constraint on those programs, the rise in cost for Social Security and the federal health care programs mean that the budget deficit under this scenario is projected to be 6.1 percent of GDP. To keep debt from rising, relative to GDP, the deficit would

need to be about $900 billion smaller in 2022; and that year alone would be the case under this scenario.

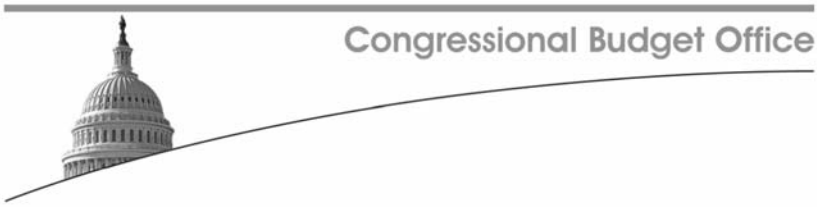
Therefore, to put the federal budget on sustainable path, policy makers will need to allow federal revenues to increase to a much higher percentage of GDP than we have seen in the past 40 years, or make very large changes to Social Security and federal health care programs, or pursue some combination of those two approaches.

Let me close by highlighting the consequential choices that policy makers face this year. One on hand, if policy makers leave current laws unchanged, the federal debt will probably recede slowly relative to the size of the economy. That will occur because of a large increase in revenues and a sharp restraint in federal spending apart from the largest programs I have mentioned. However, both of those budgetary changes from historical patterns will have significant economic and social effects. Moreover, the sharp fiscal restraint will markedly slow the economic recovery.

On the other hand, changing current laws to allow current policies to continue would boost the economy and allow people to pay less in taxes and benefit more from government programs in the next few years, but would put the nation on a quickly unsustainable fiscal course. If policy makers wanted to achieve both a short-term economic boost and medium-term and long-term fiscal sustainability, they would need to enact policies that lead deficits significantly wider than in our current law baseline for the next few years, but significantly narrower than would occur under this continuation of current policies that we have described in the alternative fiscal scenario.

In conclusion, how much and how quickly the budget deficit declines over the coming decade will depend, in part, on how well the economy does. Probably more critical though, will be the choices you make as you face the substantial changes to tax and spending policies that are slated to take effect within this year. Thank you. I am happy to take your questions.

[The prepared statement of Douglas Elmendorf follows:]



Testimony on the Budget and Economic Outlook: Fiscal Years 2012 to 2022

Douglas W. Elmendorf
Director

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Chairman Ryan, Congressman Van Hollen, and Members of the Committee, thank you for inviting me to testify on the Congressional Budget Office's (CBO's) most recent analysis of the outlook for the budget and the economy. My statement summarizes CBO's new economic forecast and baseline budget projections, which cover fiscal years 2012 to 2022. Those estimates were released yesterday in the report titled *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*.

The federal budget deficit—although starting to shrink—remains very large by historical standards. How much and how quickly the deficit declines will depend in part on how well the economy does over the next few years. Probably more critical, though, will be the fiscal policy choices made by lawmakers as they face the substantial changes to tax and spending policies that are slated to take effect within the next year under current law.

The pace of the economic recovery has been slow since the recession ended in June 2009, and CBO expects that, under current laws governing taxes and spending, the economy will continue to grow at a sluggish pace over the next two years. That pace of growth partly reflects the dampening effect on economic activity from the higher tax rates and curbs on spending scheduled to occur this year and especially next. Although CBO projects that growth will pick up after 2013, the agency expects that the economy's output will remain below its potential until 2018 and that the unemployment rate will remain above 7 percent until 2015.

The Budget Outlook

As specified in law, and to provide a benchmark against which potential policy changes can be measured, CBO constructs its baseline estimates of federal revenues and spending under the assumption that current laws generally remain unchanged. On that basis, the federal budget will show a deficit of nearly $1.1 trillion in fiscal year 2012 (see Table 1). Measured as a share of gross domestic product (GDP), that shortfall will be 7.0 percent, which is nearly 2 percentage points below the deficit recorded last year but still higher than any deficit between 1947 and 2008. Over the next few years, projected deficits in CBO's baseline drop markedly, averaging 1.5 percent of GDP over the 2013–2022 period. With deficits small relative to the size of the economy, debt held by the public drops—from about 75 percent of GDP in 2013 to 62 percent in 2022, which is still higher than in any year between 1952 and 2009.

Much of the projected decline in the deficit occurs because, under current law, revenues will rise considerably as a share of GDP—from 16.3 percent in 2012 to 20.0 percent in 2014 and 21.0 percent in 2022. In particular, between 2012 and 2014, revenues in CBO's baseline shoot up by more than 30 percent, mostly because of the recent or scheduled expirations of tax provisions, such as those that lower income tax rates and limit the reach of the alternative minimum tax (AMT), and the imposition of new taxes, fees, and penalties that are scheduled to go into effect. Revenues continue to rise relative to GDP after 2014 largely because increases in taxpayers' real (inflation-adjusted) income are projected to push more of them into higher tax brackets and because more taxpayers become subject to the AMT.

As the economy expands in the next several years and as statutory caps constrain discretionary appropriations, federal spending in CBO's baseline projections declines modestly relative to GDP before turning up again because of increasing expenses generated by the aging of the population and rising costs for health care. Projected spending averages 21.9 percent of GDP over the 2013–2022 period, a percentage that is less than the 23.2 percent CBO estimates for 2012 but that is still elevated by historical standards. Spending resulting from the American Recovery and Reinvestment Act and outlays for unemployment compensation and other benefits that tend to increase during economic downturns will continue to ebb over the next few years. Caps on discretionary spending and other procedures established in the recently enacted Budget Control Act also will hold down growth in federal spending. In the baseline, discretionary spending is projected to decline to 5.6 percent of GDP in 2022—the lowest level in the past 50 years. Those constraining factors will be partially offset by increases in spending for mandatory programs, particularly Social Security, Medicare, Medicaid, and other federal health care programs: Mandatory spending is projected to climb from 13.3 percent of GDP in 2013 to 14.3 percent in 2022.

Although the projected deficits under current law are much smaller than those of the past few years, in CBO's baseline the federal budget remains out of balance throughout the decade. The resulting accumulation of

Table 1.

CBO's Baseline Budget Outlook

	Actual, 2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total 2013-2017	Total 2013-2022
							In Billions of Dollars							
Revenues	2,302	2,523	2,988	3,313	3,568	3,784	4,039	4,243	4,456	4,680	4,926	5,181	17,692	41,179
Outlays	3,598	3,601	3,573	3,658	3,836	4,086	4,259	4,439	4,714	4,960	5,205	5,520	19,413	44,251
Deficit (-) or Surplus	**-1,296**	**-1,079**	**-585**	**-345**	**-269**	**-302**	**-220**	**-196**	**-258**	**-280**	**-279**	**-339**	**-1,721**	**-3,072**
On-budget	-1,363	-1,130	-619	-363	-282	-318	-235	-206	-258	-265	-245	-283	-1,818	-3,074
Off-budget[a]	67	52	34	19	13	16	15	10	*	-16	-34	-55	97	2
Debt Held by the Public at the End of the Year	10,128	11,242	11,945	12,401	12,783	13,188	13,509	13,801	14,148	14,512	14,872	15,291	n.a.	n.a.
							As a Percentage of Gross Domestic Product							
Revenues	15.4	16.3	18.8	20.0	20.2	20.2	20.5	20.5	20.6	20.7	20.9	21.0	20.0	20.4
Outlays	24.1	23.2	22.5	22.1	21.8	21.8	21.6	21.5	21.8	21.9	22.0	22.4	21.9	21.9
Deficit	**-8.7**	**-7.0**	**-3.7**	**-2.1**	**-1.5**	**-1.6**	**-1.1**	**-0.9**	**-1.2**	**-1.2**	**-1.2**	**-1.4**	**-1.9**	**-1.5**
Debt Held by the Public at the End of the Year	67.7	72.5	75.1	74.8	72.6	70.5	68.5	66.8	65.5	64.2	63.0	62.0	n.a.	n.a.

Source: Congressional Budget Office.

Note: * = between -$500 million and zero; 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.

debt, along with rising interest rates, drives up the cost of financing that debt; in CBO's projections, net interest costs grow significantly from 1.4 percent of GDP this year to 2.5 percent in 2022.

CBO's baseline projections are heavily influenced by changes in tax and spending policies that are embodied in current law—changes that in some cases represent a significant departure from recent policies. As a result, those projections show much higher revenues and lower outlays than would occur if the lower tax rates now in effect were extended and if provisions constraining future spending were not implemented. To illustrate the budgetary consequences of maintaining some tax and spending policies that have recently been in effect, CBO developed projections under an "alternative fiscal scenario." That scenario incorporates the following assumptions:

- Expiring tax provisions (other than the payroll tax reduction) are extended;
- The AMT is indexed for inflation after 2011;
- Medicare's payment rates for physicians' services are held constant at their current level (rather than dropping by 27 percent in March 2012 and more thereafter, as scheduled under current law); and
- The automatic spending reductions required by the Budget Control Act in the absence of legislation reported by the Joint Select Committee on Deficit Reduction do not take effect (thereby leaving in place the discretionary caps established by the act, which would otherwise be subject to those reductions).

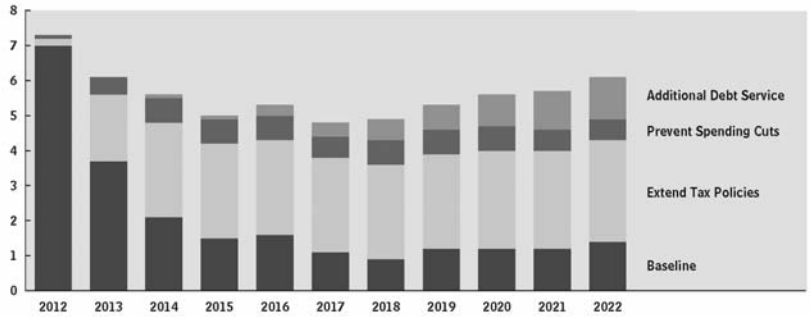
Under that alternative fiscal scenario, deficits over the 2013–2022 period would be much higher, averaging 5.4 percent of GDP, rather than the 1.5 percent reflected in CBO's baseline projections (see Figure 1). Debt held by the public would climb to 94 percent of GDP in 2022, the highest figure since just after World War II (see Figure 2).

Even if the fiscal policies specified by current law come to pass, budgetary challenges over the longer term remain—

Figure 1.

Deficits Projected in CBO's Baseline and Under an Alternative Fiscal Scenario

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Note: "Additional Debt Service" is the amount of interest payments on the additional debt issued to the public that would result from the policies in the alternative fiscal scenario. "Prevent Spending Cuts" involves holding Medicare's payment rates for physicians' services at their current level (rather than permitting them to drop, as scheduled under current law) and preventing the cuts to federal spending that will occur under the automatic enforcement procedures of the Budget Control Act of 2011 from taking effect (but leaving in place the original caps on discretionary appropriations in that legislation). "Extend Tax Policies" reflects the assumptions that expiring tax provisions (other than the payroll tax reduction) are instead extended and that the alternative minimum tax is indexed for inflation.

and the challenges will be much more acute if those policies do not remain in place. Under both CBO's baseline and its alternative fiscal scenario, the aging of the population and rising costs for health care will push spending for Social Security, Medicare, Medicaid, and other federal health care programs considerably higher as a percentage of GDP. If that rising level of spending is coupled with revenues that are held close to the average share of GDP that they have represented for the past 40 years (rather than being allowed to increase, as under current law), the resulting deficits will increase federal debt to unsupportable levels. To prevent that outcome, policymakers will have to substantially restrain the growth of spending for those programs, raise revenues above their historical share of GDP, or pursue some combination of those two approaches.

The Economic Outlook

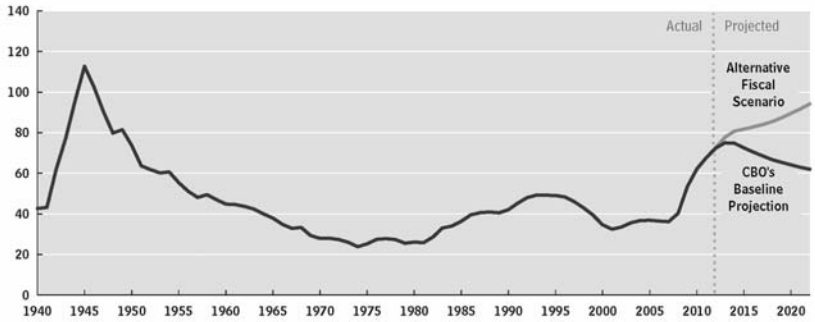
The continued slow recovery that CBO projects for the next two years reflects the lingering effects of the financial crisis and the recession, as well as the fiscal restraint that will arise under current law. According to CBO's projections, real GDP will grow by 2.0 percent this year (as measured by the change from the fourth quarter of the previous calendar year) and by 1.1 percent next year (see Table 2). CBO expects economic activity to quicken after 2013 but real GDP to remain below the economy's potential until 2018. As of late 2011, according to the agency's projections, the economy was only about halfway through the cumulative shortfall in total output that will result from the recession and its aftermath.

Considerable slack remains in the labor market, mainly as a consequence of continued weakness in demand for goods and services. In CBO's forecast, the unemployment rate remains above 8 percent both this year and next. As economic growth picks up after 2013, the unemployment rate will gradually decline, but it will still be around 7 percent at the end of calendar year 2015, before dropping to near 5½ percent by the end of 2017 and 5¼ percent by the end of 2022.

Figure 2.

Federal Debt Held by the Public Projected in CBO's Baseline and Under an Alternative Fiscal Scenario

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Note: The alternative fiscal scenario incorporates the assumptions that all expiring tax provisions (other than the payroll tax reduction), including those that expired at the end of December 2011, are instead extended; that the alternative minimum tax is indexed for inflation after 2011 (starting at the 2011 exemption amount); that Medicare's payment rates for physicians' services are held constant at their current level; and that the automatic enforcement procedures specified by the Budget Control Act of 2011 do not take effect. The budgetary effects under the alternative fiscal scenario also include the incremental interest costs associated with projected additional borrowing.

While the economy continues to recover during the next few years, inflation and interest rates will remain low. In CBO's forecast, the price index for personal consumption expenditures (PCE) increases by just 1.2 percent in 2012 and 1.3 percent in 2013, and rates on 10-year Treasury notes average 2.3 percent in 2012 and 2.5 percent in 2013. As the economy's output approaches its potential later in the decade, inflation and interest rates will rise to more normal levels. In CBO's projections for the 2018–2022 period, the annual change in the PCE price index averages 2.0 percent per year, and interest rates on 10-year Treasury notes average 5.0 percent.

Many developments could cause economic outcomes to differ substantially, in one direction or another, from those that CBO has projected. For example, the economy could grow considerably faster than the agency has forecast if the forces that have restrained the recovery fade more rapidly than anticipated. Alternatively, a significant worsening of the banking and fiscal problems in Europe could lead to further turmoil in international financial markets that could spill over to those in the United States and greatly weaken the economy here.

Furthermore, changes in fiscal policy that diverge from the path assumed in CBO's baseline also could have a significant impact on economic growth. Under CBO's alternative fiscal scenario, real GDP would be noticeably higher in the next few years than it is in CBO's baseline economic forecast. Over time, however, real GDP under that scenario would fall increasingly below the level in CBO's baseline projections because the larger budget deficits would reduce private investment in productive capital.

Table 2.

CBO's Economic Projections for Calendar Years 2012 to 2022

	Estimated, 2011	Forecast 2012	Forecast 2013	Projected Annual Average 2014-2017	Projected Annual Average 2018-2022
		Fourth Quarter to Fourth Quarter (Percentage change)			
Real GDP	1.6	2.0	1.1	4.1	2.5
Inflation					
PCE price index	2.6	1.2	1.3	1.7	2.0
Core PCE price index[a]	1.8	1.2	1.4	1.6	2.0
Consumer price index[b]	3.3 [c]	1.4	1.5	1.9	2.3
Core consumer price index[a]	2.2 [c]	1.4	1.6	1.9	2.2
		Fourth-Quarter Level (Percent)			
Unemployment Rate	8.7 [c]	8.9	9.2	5.6 [d]	5.3 [e]
		Calendar Year Average (Percent)			
Interest Rates					
Three-month Treasury bills	0.1 [c]	0.1	0.1	2.0	3.7
Ten-year Treasury notes	2.8 [c]	2.3	2.5	3.8	5.0

Source: Congressional Budget Office.

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

a. Excludes prices for food and energy.

b. The consumer price index for all urban consumers.

c. Actual value for 2011.

d. Value for 2017.

e. Value for 2022.

Chairman RYAN. So in other words, it is pretty bleak. I just sum it up. There are so many areas I could go. Let's talk about Medicare and your analytical tools in measuring what is going to become the largest federal program. We have two scenarios here which do a service of showing where we are headed. Extended baseline and alternative fiscal scenario: under the alternative fiscal scenario, which is your attempt to try and get closer to reality, that is my description, I do not know if that is yours, but from your

June 2011 long-term outlook, you show Medicare doubling as a percentage of GDP over the next 20 years, and then rising to 14 percent of GDP in 2085. By 2037, debt exceeds 200 percent of GDP. So what we find, and I think everybody agrees with this, I do not need to belabor this, is that Medicare becomes unsustainable under the alternative fiscal scenario because it drives debt to just untenable levels. So that is a future we know is not going to exist because it simply cannot sustain itself. You would agree with that, right?

Mr. ELMENDORF. So I agree with the alternative fiscal scenario cannot persist indefinitely, and as you say, you were referring to our projections over the long run from last June.

Chairman RYAN. Right.

Mr. ELMENDORF. I think it is the combination of policies in that scenario that cannot be sustained together. One could sustain the Medicare path while making other changes, or the Social Security path while making other changes, or the revenue path while making other changes, and the set of changes that will be made will depend on you and your colleagues. That combination of policies cannot be sustained over the next quarter century.

Chairman RYAN. So when we look at the extended baseline, my own experience from being on the Medicare Oversight Committee for 12 years now, is that whenever we seek to control costs by cutting reimbursement rates to providers, what we learn is that the cuts are either not sustained, meaning they are given back, or they cause higher utilization rates that actually erode the anticipated savings. The president's health care law cut Medicare payments to providers by $500 billion over 10 years to pay for the new entitlement. It also created the IPAB and under this proposal that the president has more recently put out, the IPAB will be tasked with holding Medicare's growth to GDP plus .5 percent by cutting reimbursement to providers.

Now, last year you testified that CBO has, I think as you said it, a gap in the toolkit when it comes to analyzing the behavior of physicians and beneficiaries' ability to access care. Do you still more or less have that gap in the toolkit to try and analyze behavioral changes and access on both the provider and the beneficiary side?

Mr. ELMENDORF. I am afraid we do, Mr. Chairman. It is a gap that we are trying to fill. We have projects underway, and we have been in conversation with members of our panel, health advisers, about what evidence we can draw on in trying to give the Congress a better sense of how changes in payments to providers would affect the beneficiaries access to care and quality of care, but we are at the beginning of that road, certainly not the end.

Chairman RYAN. So I obviously want to encourage you to keep doing that because we are getting analysis from the actuaries. Rick Foster, the chief actuary of CMS, was here just a few weeks after you were the last time, where he basically told us that he estimates that 40 percent of providers will become unprofitable by 2050 and therefore go out of business, or just stop taking Medicare according to the cuts in the current health care law. So they are able to make those kinds of projections. He also has told us that Medicare cur-

rently pays physicians 80 cents on the dollar, but is on course to pay physicians less than 30 cents on the dollar in decades ahead.

He is basically telling us that there are going to be massive access problems and providers are just going to stop taking Medicare beneficiaries. So we are getting this kind of analysis from CMS, I think it would be helpful to get it from CBO.

Let me ask you another question about your toolkit. There have been many health care economists, both from the left and the right, that have argued that choice and competition actually would lower cost and improve quality, and we have seen some anecdotal evidence of that even in Medicare areas. A premium support model, which we have talked about here quite a bit, you have bipartisan efforts that have been made: Alice Rivlin, former CBO director and OMB director, and I had recently worked with Senator Ron Wyden, which attempt to employ a competitive bidding process to measure the growth rate of premium support payments. Do you still lack the modeling capabilities to measure the lower cost under such a competitive premium support kind of a system?

Mr. ELMENDORF. We are working very hard to try to fill that gap as well Mr. Chairman. In the analysis that we did, for example, your proposal last spring, we were able to incorporate the effective competition and other factors on the cost of insurance through Medicare or the private sector today, but we did not have the tools to try to analyze how the flexibility of the providers that insurers would have in your proposal, or proposals like it, or how the price pressures that people would face under your proposal, or proposals like it, would affect the dynamic path of spending over time, and that is what we are working to do. Again, we are working with our panel of health advisers, getting their insights as well as our own work, but we are only partway along that road as well.

Chairman RYAN. So here is the point I am trying to make. The work you do on a long-term budget outlook with respect to Medicare and health care spending because this, as you mentioned, health care is the big driver of our debt issue in the future. These gaps in the toolkit need to be filled.

I know you face serious challenges, but I want to basically get your response to some of the caveats I have so we can better understand how Medicare analysis works today to get a better understanding of what we are really looking when we get these analyses and where they are lacking. When you compare the impact of proposed Medicare reforms relative to the alternative fiscal scenario, we acknowledge that that scenario is unsustainable. The comparison, therefore, is really not fair or accurate since it is based on a scenario in which the federal government would not have the means to fully fund Medicare benefits to beneficiaries, so we do not want to compare ourselves to some mythical future that we know is unsustainable and will not exist.

When you compare Medicare reform options to the extended baseline, we ignore the notion that providers, if they are going to be paid 30 cents on the dollars, are not going to be continuing to provide benefits. So that scenario is pretty implausible, and we are not capturing a dynamic and a phenomenon that has been advocated by experts on both sides of the aisle that choice and competition actually work to reduce costs, or to tame inflation. So I think

it is important to acknowledge that we are not fully capturing a proper analysis of what reforms actually achieve relative to these two scenarios which we know are pretty much untenable, or at least we cannot even measure the full effects of these two alternative scenarios. Is that pretty accurate?

Mr. ELMENDORF. I certainly think we have not provided you with all the information that we would like to provide to help you and your colleagues understand better the trade-offs that you face. As you know Mr. Chairman, let's make sure others understand, over the course of this past year we have worked desperately hard for a succession of deficit reductions that have been pursued on the Hill.

Chairman RYAN. I know.

Mr. ELMENDORF. Much of that work involved proposed changes to health care programs, even though those were not ultimately voted upon. So I have a team of people who have been doing an awful lot of work on a number of proposals, but it has, no doubt, slowed our work on the ideas that you are discussing. Now, what effects we will find when we finish this work are unclear, I think. There was an exchange recently in the last couple of weeks in the New England Journal of Medicine about premium support plans, that leading health economists wrote for and against. Both the for and against people were members, our members, on our panel of health advisers were among people that we have consulted. I do not know, I do not want to prejudge what our findings will be, but I agree, and we all agree at CBO, that we need to push very hard to bring more to bear to give you a fuller sense of the true choices that you face.

Chairman RYAN. That is basically the point I am trying to make. Look, we understand that there was a lot of interplay in Congress on all super committees and all of these efforts which tied up CBO analysts to do that work instead of trying to improve on the analysis of these kinds of health care reforms, but the problem is that where we are is that these programs, which are the biggest drivers of our debt in the future, we are measuring in a reform effort against two futures that we know, based on the latest CMS analysis and outside analysis, are untenable. We know, from other analysis, that if we pay providers pennies on the dollar, they are just not going to keep providing. What good is having a program if no provider will actually provide the benefit?

And then we also know that if we stick with the status quo, meaning current policy baseline, that our debt gets so out of control that basically we go into a tailspin. So there has got to be another way, and we need to make sure that we have a better analytical toolkit to analyze how best to chart that better way, and we just have our work cut out for us still. With that, let me turn it to Mr. Doggett.

Mr. DOGGETT. Thank you very much, Mr. Chairman, and thank you Dr. Elmendorf for your testimony, service, and the various studies that you bring to our work.

Mr. ELMENDORF. Thank you.

Mr. DOGGETT. I think all America would benefit if we were able to return to the prosperity of the Clinton years, contain the short-term deficit as we did when President Clinton was in office, and

begin to work together to address these long-term challenges of soaring health care cost. I think we have to do it in a way that is different from what the chairman recommends because I believe whatever label you put on it, what is basically a Medicare voucher system simply shifts those health care costs onto vulnerable seniors and individuals with disabilities, and does not really resolve the problem, it just shifts the problem from the taxpayer to the seniors.

Looking at the issues of how we advance our immediate economic growth, your office put out a study back in November that looked at the impact of the Economic Recovery Act and while I believe you had a wide range of the effects of that act, all of it was positive, was it not, encouraging economic growth and encouraging job growth.

Mr. ELMENDORF. Yes, we think the effects over the past few years have been certainly positive and we have a range reflecting the uncertainty in the economics' literature.

Mr. DOGGETT. And that range reflecting the uncertainties of even predicting the past, if you will, that range suggested that growth may have been advanced through the Economic Recovery Act by over 4 percent in 2010, and again by over 2 percent in 2011, and that the Economic Recovery Act may well have been largely responsible for creating millions of jobs in this country, is that right?

Mr. ELMENDORF. Yes, you have identified the high ends of those ranges, Congressman, and you have identified those correctly.

Mr. DOGGETT. And looking at the effects of the Economic Recovery Act and the composition of it, and then trying to understand what that means for policy choices now, again those policies that would place dollars into the pockets of the families that need them the most right now, for example, extending unemployment compensation; that is the type of policy that will encourage economic growth, is that correct?

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

Mr. DOGGETT. The same thing would be true of a good infrastructure investment in terms of roads, and bridges, and rail across the country. Those also would be likely to encourage economic growth.

Mr. ELMENDORF. Yes, Congressman, they would.

Mr. DOGGETT. And on the other extreme, other than building things that taxpayers can see the advantages of in encouraging economic growth, how does it compare to eliminate the inheritance tax, the estate tax in terms of encouraging economic growth? Does that have much real benefit in encouraging job growth?

Mr. ELMENDORF. Congressman, I do not think we produced estimates of changes in the estate tax directly. We prepared a long testimony for the Senate Budget Committee in the fall that had a chart of this sort that looked at the effects of different sorts of tax and spending policies in boosting economic activity this year and next. On the higher end of the ranges, the policies that seem to have a higher bang for the buck, if you will, are increasing aid to the unemployed and payroll tax reductions for employees or employers. On the lower end of the range are things like broad based cuts in income taxes, but also on the low end of the range for the next few years, actually, is infrastructure spending. That is not because it does not matter when it happens, but because it tends to

happen rather slowly after the Congress acts because of the planning and contracting process.

Mr. DOGGETT. And specifically, since you mentioned the Senate and the effect of changes in the tax rate, I believe that you did a study that was presented in the Senate in 2010 concerning what the effect would be of extending, over the next decade, the Bush tax cuts, and what did you find would be the effect on economic growth of extending the Bush tax cuts?

Mr. ELMENDORF. So our findings in that testimony, consistent with what I have said today, is that extending those expiring tax cuts for a few years provides a boost to the economy during those few years, but will, by the end of the decade and beyond, be a drag on GDP because the effects of the accumulating debt and crowding out private investment outweigh the beneficial effects of lower tax rates; and that is what we showed in this testimony you are referring to from 2010 in the Senate, and again, consistent with the analysis we presented in this outlook yesterday.

Mr. DOGGETT. Exactly, though it sounds really great in political speeches, the actual effect of extending the Bush tax cuts over the next decade is to reduce economic growth by between 1 and 2 percent. Is that not correct over the decade?

Mr. ELMENDORF. Yes, again, there is a range of estimates depending on precisely what one does in the economic assessments.

Mr. DOGGETT. That range does not include any plus economic growth, all of it is negative in extending those tax cuts.

Mr. ELMENDORF. Right, so in the outlook we released yesterday, Congressman, I think what you are referring to when we looked at the effects of the alternative fiscal scenario, which is the tax cuts plus some other things, but the effect of that set of policies is to boost the economy we think, over the next few years, but by 2022 to reduce GNP by between 1 percent and 3.7 percent relative to what would occur under the current law baseline.

Mr. DOGGETT. And there were a number of things in that alternate baseline that you looked at, other than the negative effects of extending all these tax cuts over the next decade, during the short-term, if I understand your testimony to Chairman Ryan, it is that if we reduce the short-term deficit too quickly with sudden reductions in expenditures for vital public services, it will actually retard economic growth in the short-term.

Mr. ELMENDORF. Yes, I think that is right Congressman. Reductions in the deficit too quickly, through either tax increases or spending reductions, would retard the economic recovery and that is consistent with, I think, the consensus of thinking in the economics profession, consistent with the experience that we are seeing in Europe where countries that are in worse budget shape that we are and are forced by their inability to borrow to make very drastic changes in policy very quickly are suffering economic consequences from that. When we wrote an issue brief a year or so ago about the risk of a fiscal crisis in the United States, one of the risks that we highlighted was that budget situations tend to deteriorate when the economies are already in trouble, and that makes it a particularly bad time to then have to implement these changes very quickly, that emphasizes the importance of Congress acting before we had a crisis of that sort, but given the low level of cur-

rent Treasury interest rates, our continued ability to borrow, for now at least, I think many experts believe that although that the changes should not be implemented right away; and I want to emphasize that is not an argument against the Congress deciding upon what changes in policy to make, given the scale of the changes that will be needed relative to current policies, but more warning that people have and business have, that state and local governments have, about what policies will be undertaken, the better it will be.

So there is a real cost to waiting to decide upon the courses of action. Once one is decided, then there is a more difficult tradeoff about the speed. Waiting too long, of course, has the cost of ending up in a fiscal crisis. Moving too quickly has the cost of slowing the economic recovery.

Mr. DOGGETT. So pursuing an aggressive austerity program similar to that that the conservative government in the United Kingdom has pursued, and some of the other European countries, is likely to present some of the same type of economic problems for us that it is presenting today to the Europeans.

Mr. ELMENDORF. I think that is right Congressman. I want to be careful not to second-guess the decisions those governments have made. They face a particular set of circumstances and I think in some cases had no choice because of an inability to borrow money or a fear that they would be unable to borrow money in the very short-term. So I am not suggesting that they have done the wrong thing, necessarily, we have not studied their choices carefully enough to speak to that; I am just using that as an example of that sort of very sharp fiscal contraction does weigh on economic activity and jobs in the short run.

Mr. DOGGETT. And as far as encouraging more jobs, though it is not my preferred policy choice, extending the payroll tax cut is one very positive way of encouraging economic growth.

Mr. ELMENDORF. Yes, we think so Congressman.

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

Chairman RYAN. Thank you, Mr. Garrett.

Mr. GARRETT. So just following up on a couple of points we just raised on this point. With regard to what was done in Europe and the decision making there, obviously, as you correctly say, we cannot second-guess them. Some of that goes to one of the questions I have is, your presumptions on interest rates. According to your baseline, the American people will be paying about $4.3 trillion in net interest over the next 10 years based upon, I think it is on Page 30 or 31 of the charts, and what have you, but obviously if those interest rates are skewed in a different direction, that number goes up significantly, right?

Mr. ELMENDORF. Yes, Congressman, no doubt.

Mr. GARRETT. What is that?

Mr. ELMENDORF. Yes.

Mr. GARRETT. And right now we have the benefit of the fact that we are the reserve currency of the world, and that is able to keep it down, but we saw what occurred in the private sector, how the spreads changed in 2008 basically overnight because these various companies that initially had very good rates, is that not correct?

Mr. ELMENDORF. Yes, that is right.

Mr. GARRETT. And did we not see the exact same thing that occurred over in Europe with the PIGs, with Portugal and Italy and Greece especially, that their interest rates were somewhat favorably for, but basically in an overnight, figuratively overnight period of time, the spreads expanded beyond anyone's projections. Is that a fair assessment?

Mr. ELMENDORF. Yes, that is right. I mean, I'm not sure of anyone's projections, but certainly in a way that surprised many observers. Yes, I think a significant risk in our projections is the interest rates will rise more rapidly than we have projected. I should say there is risk on the other side, too. Our projection of interest rates lies well above the rates that are implicit in current financial market transactions when one can essentially back out of the Treasury yield curve, the market's predictions of interest rates over the second half of the decade.

Mr. GARRETT. But they are certainly not above historical averages for the United States. All we have to do is go back and look into the Carter years and we would see those rates off the charts, and that would put this number at a multiple of this 4.3 trillion. Is that not correct?

Mr. ELMENDORF. Yes, that is right.

Mr. GARRETT. So within our lifetime we have seen interest rates in this country dramatically above where they are.

Mr. ELMENDORF. Yes, Congressman.

Mr. GARRETT. Which may give, in the final point of this, credence to the argument that whether we not overly aggressive contraction, but an aggressive contraction as far as spending, might be the prudent direction this Congress should go in.

Mr. ELMENDORF. Yes, I think and we have said in other testimonies as well, that there is this trade-off.

Mr. GARRETT. Right, I understand that. Let me just go back on something. Earlier this past month, a bill came out of this committee, 3581, the Budget and Accountability Transparency Act, which among other things changes the credit reform methodology. You are familiar with that, I am sure?

Mr. ELMENDORF. Yes.

Mr. GARRETT. Back in June, CBO testified before the Committee, quote "By including a market based risk premium, fair value estimates provide a more comprehensive measure of cost which recognizes that financial risk that the government assumes when it is issuing guarantees, is more costly to the taxpayers than estimates suggest." In other words, fair accounting suggests. Do you agree?

Mr. ELMENDORF. Yes, Congressman. We believe that the fair value method of accounting for federal credit transactions provides a more comprehensive measure of their true cost.

Mr. GARRETT. Okay, moving on to another topic that we have had in discussion here, and that is the FHA bailout. Very quickly then, on FHA bailout, there is a possibility, it reports that chances of future net losses on the current outstanding portfolio could exceed current capital resources at close to 50 percent, which could necessitate a taxpayer bailout for them. Currently the numbers show that their leveraging ratio is around 400 to 1, which obviously makes everything else that we have been seeing on Wall Street basically pale by comparison. Have you all examined this? Have you

examined the budgetary implications if we have to go through a bailout for FHA; and B, what would the implications be to the debt limit; and C, a quick answer on that one is can you give a projection as to the next debt limit increase?

Mr. ELMENDORF. So you are correct, Congressman, that the reserves that FHA holds are below the statutory minimum, but there will be no bailout required in the sense that the Congress does not need to take any action to deal with this low level of reserves. If more people default on FHA guaranteed mortgages than FHA has reserves for, then like other federal credit programs, there will be what is called a credit re-estimate. There will be an assessment of a higher cost that will be recorded in the budget, but will not require the Congress to take any explicit action. This is the case for all federal credit programs. What it will mean, of course, is that if the FHA does not get money back, or pays money out, that it would not have to, then that will affect future government borrowing.

Mr. GARRETT. So the estimates that we have seen by analysis that we may have to pony up another $50 to 150 billion at that 2 percent capital level which is now at .25 basis points goes to zero, and they will not have the money actually to make the payments, that we would not actually have to come up with the cash to pay that is incorrect?

Mr. ELMENDORF. Depends what you mean by whether you have to pony up. What I was saying was that automatically, in the budget, without Congressional action there will be no vote about whether to bail out the fund.

Mr. GARRETT. But my question was have you have seen what that impact would be on the budget deficit?

Mr. ELMENDORF. Yes, so our baseline projection includes our assessment of what the cost will be for FHA going forward, and I think that is incorporated in the projections that we have shown.

Chairman RYAN. We have a lot of members here, so with all due respect, we have to keep to the time so everybody can get a chance. Mr. Blumenauer.

Mr. BLUMENAUER. Thank you, Mr. Chairman. Thank you, doctor, for the good work that your staff does and your patience with this committee coming before us as we plow some of the same ground, but I think each of your visits, for me, provides greater clarity, and I am not as grumpy as our chair. I think there is a pretty clear path going forward which actually is buried in your report, implicit in your testimony, and I think what most of the people here can sort of get their arms around. The chair references the problem we have had in controlling Medicare costs, for example, over time, and it is because we have a flawed payment system more than anything else, and as long as we are going to pay for volume, people will up the volume. Congress will, when the heat comes on, dial down what purported to be reforms and it is a bipartisan failing. Congress has folded. More volume, less value.

What we have in the Affordable Care Act, at least, is an outline of things that if your studies show if allowed to work over the course of the next 20 years, would have a substantial affect on bending the cost curve. I think we could have a very robust conversation around this table if we focused on how we right-sized the military. I think most of us do not think we need troops in Western

Europe 65 years after World War II. We can dramatically scale down what is necessary to maintain a nuclear arsenal. Do we need 12 multi-billion dollar aircraft carriers and build another one, when nobody else in the world has even one that is comparable to what we have got; and you do not build those things overnight, so we could gear up if some change took place.

I mean, I go through the things with the chairman on agriculture, and actually that was, I thought, a little bright spot in an otherwise mixed bag that was offered up. There is a chance to come together to actually save money. What you buried in your testimony there, I loved the line where you talked about the various scenarios going forward, but you talked about one where the deficit scale is up a little bit in the short-term, but with balanced policies that deal with refinement and revenue, we can end up having lower deficits in the out year without economic disruption that are predicted with some of the other scenarios that you are talking about.

I would hope that we get to the point where this committee starts zeroing in on areas of agreement that are not necessarily ideological or partisan, but really point us towards the path that you have outlined. I think it is very, very important. One thing that I am concerned about is equipping you to be able to help us go through. There was a fascinating article in Ezra Klein's column this morning where he talked about how much of the deficit is attributed to policies that President Obama signed into law, and how much is attributable to policies that were part of the Bush administration. He comes up with a calculation $1 billion Obama, $5 billion Bush administration policies.

Now to debate, more or less, what you are talking about on this, but this should not be from a columnist in the Washington Post and a couple of think tanks. It would be great to be able to work in a refined basis with you on things like that going forward; but I wish that you would comment on your capacity to deal with the demands of this committee for more data, more methodology, more ideas that are coming thick and fast; that we want faster turnaround, and the implications of what we do with the data is profound, dealing with trillions of debt and spending in the out year. What is happening to your budget and your ability to respond to this committee?

Mr. ELMENDORF. I appreciate your concern.

Chairman RYAN. And please answer in 30 seconds.

Mr. ELMENDORF. I appreciate your concern for our capacity, Congressman. Certainly for the three years that I have been at CBO, the demand for work for us has greatly outpaced our ability to supply it, and we feel bad about that all the time, and the chairman referred to some specific cases, but it happens many, many times. I am on the phone with colleagues of yours apologizing for work we have not been able to get to.

On the specific question, yes our budget is being reduced, I think along with the budgets of the other congressional support agencies and the committee staffs, and from my parochial perspective, that is too bad, but it is not for us to judge that decision of the Congress any more than we can judge the other divisions of the Congress.

Mr. BLUMENAUER. Right, my time is expired, I appreciate the chair's patience, but I think that this is one thing that we ought to look at. Cutting their budget 10 percent when we are throwing more things at them and there is more that relies on what they can produce for us, is something that every member of the Budget Committee ought to maybe reflect on, if that is maybe not penny wise and pound foolish.

Chairman RYAN. As you know, that is the jurisdiction of the Appropriations Committee, but thank you. Mr. Campbell.

Mr. BLUMENAUER. No, no. We are so persuasive I think it would make a difference if we outlined being the budget torch carriers.

Chairman RYAN. Mr. Campbell.

Mr. CAMPBELL. Wow, it is like I am at concerts ready to sing. If I do sing I think I would rather sing like President Obama than Mitt Romney, unfortunately, but one of them would be better at being president, but that is not what we are here to talk about, and not the same one that is better at singing. I do not know whether I will be as obedient as Mr. Blumenauer, as grumpy as Mr. Ryan; I will try to be cheerfully realistic.

Dr. Elmendorf, good morning. The ranking member, in his opening comments, threw out a couple of figures that if all the Bush tax cuts were allowed to expire and the AMT index et cetera, it would raise about $6.3 trillion using static modeling, which those of here do not always subscribe to, but $6.3 trillion over the 10 years. He also said that if it was just the wealthy, which I presume is $250,000 or more, since that is the number the president has thrown out, it would raise about a trillion. I do not know whether those numbers are correct, but if they are, and you can tell me if they are roughly in the ballpark, then that means that the over $250,000 account for about 15 percent, roughly, of the total tax potential if you let everything expire over the next 10 years, is that correct?

Mr. ELMENDORF. I think that is right, Congressman. It is about 20 percent of the set of tax provisions enacted 2001, 2003, 2009. Then we also show on our tables other expiring tax provisions, including, for example, the research and experimentation tax credit to set more standard tax extenders. So I think the effects of the top tax rate as being about a fifth, based on the latest estimates I have seen from the staff of the Joint Committee on Taxation, of the set of things often described as the Bush tax cuts.

Mr. CAMPBELL. Right, okay. So if you take all of the different tax things, 15 to 20 percent let's say, then if you wanted to get to the alternative scenario, and you only raised taxes on $250,000 or more, then you have to take, roughly, 80 to 85 percent of the rest of that money and get it out of spending, is that correct?

Mr. ELMENDORF. Yes, I think that is right. I mean, the alternative fiscal scenario said what if you do not do these things, and I think what you are saying is that the piece, which is just raising those top tax rates, only makes a small difference in moving the alternative fiscal scenario back toward the current law baseline.

Mr. CAMPBELL. Correct, thank you, and the reason I bring this up is there is obviously a lot of rhetoric that goes on, that somehow we can solve the deficit problem with just that slice of the populace, and we cannot. If you want to do that, then you have to do

a lot on the spending side, or you have to increase taxes on virtually everybody to get more towards the alternative scenario.

Second thing I would like to ask about, and I think I have these numbers correct, but the health care law, which we affectionately call Obamacare, the numbers on that were on the basis of some late 2009 CBO projections, and at that time CBO projected that unemployment would be 4.9 percent in 2014. From looking at your thing here, you have 2013 at 9.2 percent. You have 2014 through 2017 at 5.6, so clearly in 2014 you project, now, significantly more unemployment.

Mr. ELMENDORF. 8.7 percent.

Mr. CAMPBELL. Okay, 8.7 percent you now project in 2014 versus 4.9 percent when CBO's numbers scoring the Obamacare law were put into effect. So, if we were rescoring that today, based on the scores that you have today because that is when some of the Medicaid increases and exchange subsidies kicked into effect, would not the cost of Obamacare be projected to be significantly larger because of that much higher unemployment figure?

Mr. ELMENDORF. So that piece alone would raise the cost of the Affordable Care Act. I do not know by how much. We say this in the outlook, but I should emphasize, we are not able, for this outlook, to update those estimates; that is a particularly involved job. We will be doing that as part of our March baseline, which is due out in just a month and a half we hope. In the March baseline you will see new estimates of all of the programs in the budget, but part of that will be new estimates of the cost of the coverage provisions in the Affordable Care Act, and onboard that change.

Mr. CAMPBELL. Right, that and then the CLASS Act which we may be dealing with this week and the fact that likely that is going to be pulled back. Thank you very much; I yield back the remaining three seconds of my time.

Chairman RYAN. Ms. Bass is next in line.

Ms. BASS. Thank you for your testimony this morning. Earlier when we opened, I believe the chair mentioned the need for the president to present solutions instead of just criticizing, and I just wanted to mention that yesterday the president sent his Start Up America Legislative Agenda to accelerate start up and small business growth to Congress. Parts of this agenda have already won bipartisan support in the House, including allowing small businesses to raise capital using social networks and eliminating taxes on capital gains and key investments in small businesses; and I think this is an example of the types of economic stimulus we should be pursuing, and I am hoping that my colleagues on the other side of the aisle will bring the president's package to the House floor for a vote soon.

I did want to ask you about states and the fiscal pressure on states, which I do see as a major obstacle to sustainable recovery. At the start of 2012, 29 states have already projected a gap of about 44 billion for fiscal year 2013, and I imagine that this number is going to grow. Given that federal aid was a lifeline for states and now, far from providing assistance to states, I am sure that we will likely be proposing additional cuts. I wanted to know if you could respond to what toll on the overall economic growth is due to states still facing a long and uncertain recovery.

Mr. ELMENDORF. Congresswoman, of course we do not study state budgets as carefully as we study the federal budget, but state budgets do matter for the overall economic outlook for the economy, and for the federal budget outlook as well. States, as you know, have been through a terribly tough time. Things are a little brighter than they used to be; revenues have started to grow a little bit in many states, but the overall levels of revenues remain well below what they were, in most cases, before the recession. Obviously, the experiences varies a great deal across states, but in general, revenues remain well below pre-recession levels.

As you have said, the federal support, much provided through the Recovery Act of 2009, is extra federal support and is now waning, which will put increasing pressure on state budgets. One way in which that matters for the economy is that state and local governments have been reducing their level of employment. So if you look back from the peak of the business cycle, before the recession started at the end of 2007, since then state and local governments have shed nearly half a million workers and that is part of what has, not a large part, but a non-trivial part of the loss of jobs.

Ms. BASS. Thank you. Could you also comment about the proposed changes to unemployment insurance, specifically what impact it would have on the economy to reduce the number of weeks, that is currently being proposed?

Mr. ELMENDORF. I will answer the question sort of a little backward, if I might. Our baseline, our projections that you see assume current law and thus assume the expiration at the end of this month; however, if the Congress were to extend the emergency unemployment benefits along the same lines that they are currently in place, and that is one of many options of course, that they would extend along the same lines that would add maybe about a quarter of a percent to the level of GDP at the end of this year without any other changes in policies, and that would then add maybe about a quarter million jobs by the end of the year.

Ms. BASS. Thank you. Chairman Ryan. Mr. McClintock.

Mr. MCCLINTOCK. Thank you, Mr. Chairman. Mr. Elmendorf, we have been hearing a recurrent them from the other side that the recovery is pretty strong, the economy is getting better, of all is well with the world. Let me ask you, are there more people working today or fewer people working today than on Inauguration Day of 2009?

Mr. ELMENDORF. I believe the answer to that is there are fewer people, Congressman.

Mr. MCCLINTOCK. Is the unemployment rate higher or lower than it was on Inauguration Day?

Mr. ELMENDORF. To be honest, Congressman, I do not know the unemployment rate on Inauguration Day.

Mr. MCCLINTOCK. In January 2009 I believe it was 7.8 percent. Is that higher or lower than it is today?

Mr. ELMENDORF. So the current rate is higher than that rate that you have identified Congressman.

Mr. MCCLINTOCK. And if the labor participation rate had remained the same as it was on Inauguration Day, that is if so many workers did not get discouraged and leave the workforce, what would the unemployment rate be today?

Mr. ELMENDORF. Let me see if we have an answer to that question. I am sorry; I do not have that off-hand Congressman.

Mr. MCCLINTOCK. Would you say it is over 10 percent?

Mr. ELMENDORF. I do not know. It is a complicated question; I do not want to speculate.

Mr. MCCLINTOCK. Is the debt higher or lower today than it was on Inauguration Day?

Mr. ELMENDORF. The debt is higher, Congressman.

Mr. MCCLINTOCK. How much higher?

Mr. ELMENDORF. Again, Congressman, I have a lot of tables, but they do not really keep track of political events, they keep track mostly of economic events.

Mr. MCCLINTOCK. Would $4.5 trillion more be in the ballpark?

Mr. ELMENDORF. That may be right; I do not know.

Mr. MCCLINTOCK. How about the price of a gallon of gasoline, more or less than it was on Inauguration Day?

Mr. ELMENDORF. I am sorry Congressman, I do not know.

Mr. MCCLINTOCK. Would it be up about 83 percent, perhaps?

Mr. ELMENDORF. I do not know.

Mr. MCCLINTOCK. Let me ask you this. We heard it said that we just need to go back to the Clinton prosperity, and I would heartily agree with that. That looks awfully good by today's standards. Did the Clinton administration increase or decrease spending as a percentage of GDP during his eight years in office?

Mr. ELMENDORF. I can check; we have these nice tables in the back of our book.

Mr. MCCLINTOCK. As a percentage of GDP, did it not decrease under the Clinton administration by a whopping 3.5 percent?

Mr. ELMENDORF. Depends, of course, how one aligns the fiscal years with the presidencies. Fiscal year 1994, for which the budget was set in 1993, spending was 21 percent of GDP, and in the year 2000, it was 18.2 percent of GDP.

Mr. MCCLINTOCK. So he cut spending relative to GDP?

Mr. ELMENDORF. Well, I would have said that the president and the Congress in that era made a set of decisions.

Mr. MCCLINTOCK. Give credit where credit is due, the president signed that legislation. Did he expand or contract the federal government's entitlement obligations during this period?

Mr. ELMENDORF. That is a hard question to answer Congressman, I do not have it off-hand.

Mr. MCCLINTOCK. I am referring to specifically to welfare reform that abolished the open ended welfare system that we had at the time.

Mr. ELMENDORF. Yes, so that was a change.

Mr. MCCLINTOCK. Did it turn in deficits or surpluses during the last four years of his administration?

Mr. ELMENDORF. There were several years of surpluses, Congressman.

Mr. MCCLINTOCK. Okay, so Clinton reduced spending relative to GDP, he contracted our entitlement obligations, he turned in budget surpluses during his final years in office. Bush, on the other hand, increased spending relative to GDP, expanded our entitlement obligations, and turned in major budget deficits. It seems to me if increasing spending, increasing our entitlement obligations,

and turning in major deficits were the path to prosperity, we should be in the golden age of the American economy right now.

Let me ask you this question. How does this recovery track with the Reagan recovery? Senator Phil Gramm has estimated that if the economy tracked under the Obama administration as it did under the Reagan administration; and if you recall, Reagan inherited a double digit unemployment, double digit inflation, mile long lines around gas stations, interest rates at 21.5 percent. Gramm estimates that if the economy tracked today as it did under the Reagan years, at this point of the administration there should be 16 million more Americans working with per capita income $4,000 higher than it is today. Do you have a comment on that?

Mr. ELMENDORF. No doubt Congressman this recovery has been very unusually weak by U.S. historical experience, and we have shown charts like that.

Mr. MCCLINTOCK. One final quick question, and that is last year we had a number of experts including yourself warning that we were about five years away, at best, from a sovereign debt crisis. Where are we today?

Mr. ELMENDORF. I was not one of the people who put a date on that. What we said consistently is that is very difficult to predict: what set of economic and budgetary circumstances, what set of political dynamics will drive financial markets to stop being willing to lend a government money at reasonable interest rates?

Chairman RYAN. Mrs. Castor.

Ms. CASTOR. Thank you very much. Thank you for your testimony. The economy is creating jobs right now. The trends are positive; they are in the right direction. Private sector payrolls added nearly 1.9 million jobs in 2011. The announced unemployment rate in December is 8.5 percent, which is the lowest in three years. We always hear that if the economy can create more jobs, it would lower the deficit. Could you give us a little more detail on that? I know you have a certain projection, now. If your projections of the unemployment rate, if we created more jobs how does that reduce the deficit?

Mr. ELMENDORF. So we actually wrote a letter, which I was looking for but cannot find off hand, to Congressman Van Hollen a few months ago that talked about the effects of a stronger economy on the budget, and the largest part of the widening of budget deficits over the past few years has been the weakness of the economy. The explicit actions of the government, the Recovery Act and other things, have also led to wider deficits, but the largest part of the widening has been the automatic changes, particularly in revenues, but also on the spending side to a weak economy: less taxable income, more people out of work, and those things have had a big effect on the budget. A very important part of the narrowing that we see in the budget deficit over the next few years under current law is improvement in the economy. There is also, of course, a very large part, which is the changes in policies scheduled to take effect under current law; but the economy matters a great deal. We show in an appendix in this outlook a rule of thumb for how stronger or weaker economic growth would affect budget outcomes.

Ms. CASTOR. Is there a precise number, if the unemployment rate is reduced, say, by .2, the exact impact that has on cutting the deficit?

Mr. ELMENDORF. There certainly is not a precise number in my head, whether we could estimate a number for you, I think we probably could. I did find the letter we wrote to Congressman Van Hollen, this was actually October 4th of last year. In this experiment I think we looked at the effects of moving the economy all the way back to its potential level, but we could certainly look, Congresswoman, at what the effects of a particular change in the unemployment rate might be.

Ms. CASTOR. Because this is the great frustration, that over the last year the Congress really has the ability to do some things, for example, the Transportation Bill that is long overdue, I know you said there is a lag there, but what if we had gotten it done a year ago? What if we had some short-term investments in some jobs initiatives that the president laid out in the American Jobs Act? People at home love the idea of repairing schools, putting people to work there; we have got so many bridges in the state of Florida and schools that are in need of repair, and it would just seem to be a great common sense solution that would put people back to work and help us reduce the deficit.

Mr. ELMENDORF. I found the answer to your specific question, actually, and this was in the letter to Congressman Van Hollen. We estimate that a one percentage point reduction in the unemployment rate would reduce the deficit by about a half a percent of GDP, using some average historical relationships.

Ms. CASTOR. Great, thank you very much. On another topic, colleagues, we really should all be working together to try to find a solution on a permanent Medicare "doc fix." I know one proposal that is being considered is looking at the savings, President Obama has now ended the war in Iraq with the support of the American people, and there are savings in the overseas contingencies funds, which are the funds where, I guess, CBO has said we are going to anticipate staying in Iraq longer. What is available in the OCO for us to use in possibly developing a permanent fix so that our parents and grandparents can maintain their relationship with the doctor of their choice?

Mr. ELMENDORF. So let me try to explain this issue of the Overseas Contingency Operation funding and how it appears in our projections; I think it is a technical and complicated one. Let me try to explain for everyone. There is not an OCO fund in the sense of a set of money which is sitting somewhere. What our baseline does do is for discretionary spending that is not capped by the Budget Control Act, and this OCO funding is not capped by the Budget Control Act, for that sort of funding we take the latest level of appropriations provided by Congress, and we extrapolate that with increases for inflation over time, and that extrapolation from the latest funding that Congress has provided for those purposes amounts to about $1.4 trillion over the coming decade; but that is just our extrapolation based on the latest actions of the Congress, and how the Congress might want to think about that money in relationship to other things that Congress wants to do, is really up to you all.

Chairman RYAN. Which is all borrowed money.

Mr. ELMENDORF. Well, there is a lot of tax revenue, there is a lot more spending than tax revenue; we are borrowing a lot for some purpose, Congressman.

Chairman RYAN. Thank you. Mr. Stutzman.

Mr. STUTZMAN. Thank you, Mr. Chairman and thank you Mr. Elmendorf for being here today and I really appreciate your testimony today and I think we would all be wise to take your report and act upon it. I would like to touch on two things. I would like to touch on the tax rate, and then also on Social Security a little bit. Could you, and maybe you touched on this a little bit and maybe I missed it, but could you touch on if Congress would raise taxes at the end of this year outside of the payroll tax rates, what kind of effect would that have on the economy immediately?

Mr. ELMENDORF. If Congress did nothing, so the tax rates automatically increased going into next year, then we have shown an estimate in the outlook for the effects of that and other policies together, but I can give you an estimate for the effects of the tax piece alone. Let me be clear about what experiment I have in mind here. In the current law baseline, taxes go up and spending is cut, particularly because of the Budget Control Act; and our economic forecasts has conditioned on that. If instead the Congress extended the expiring tax provisions for the next few years, then that would increase the level of GDP at the end of 2013 by between .3 percent and 2.5 percent, by our estimates. That is about two-thirds of the total effect of this alternative fiscal scenario that we show in the outlook, the other third is the effects of relaxing the spending cuts that we include in the scenario.

Mr. STUTZMAN. Would you recommend that Congress extend the current tax rates for three to five years to boost the economy and then revisit the issue once the economy started to progress?

Mr. ELMENDORF. It is not our place, Congressman, to make recommendations, but we have tried to illustrate here in the analysis we did and the comments I have made, the short-term negative economic consequences of fiscal contraction that is very rapid, and of course, as you understand, as we talked about there are long-term very negative economic consequences of our not having fiscal restraint relative to the current policies in place.

Mr. STUTZMAN. I think the facts are pretty clear that if we would raise taxes, if taxes were to be raised at the end of this year, that could be a detriment to the current state of our economy, is that correct?

Mr. ELMENDORF. We think that the increases in tax rates built into current law for the end of this year, will reduce economic activity and employment next year, relative to what would occur if those tax rate increases were deferred.

Mr. STUTZMAN. I want to touch on the payroll tax rates currently. Your estimate of the deficit does not include any costs associated with extending the payroll holiday. What is the cost of extending the payroll holiday to the end of this year and what would be the deficit that would be added to that cost?

Mr. ELMENDORF. If the lower payroll tax rate were extended through the end of this calendar year, we estimate that would add $75 billion to the fiscal year 2012 deficit, and $25 billion to the fis-

cal year 2013 deficit; of course that is just because fiscal year 2013 starts in the last quarter of this calendar year. So the total is about $100 billion.

Mr. STUTZMAN. So what does that do to Social Security? How many years are we shortening the life of Social Security if we continue the current rates?

Mr. ELMENDORF. Well, it has no direct effect on the Social Security trust fund. It depends, of course, how you do it, but what has happened in these lower payroll tax rates so far is that general revenue has been transferred to the Social Security trust fund in the amount of the foregone payroll tax receipts. So the trust fund has been held harmless on the lower payroll tax rate, and if you extend the lower payroll tax rate with the same provision as is in place now, then the trust fund would continue to be held harmless. If you did not do that, then the trust fund would be $100 billion to the worse by the end of the year, relative to what would happen under current law. I do not know what effect that has on, say, the expiration date of the trust fund. The trust fund is trillions of dollars, we think the Old-Age and Survivors Insurance fund, that part of Social Security has decades before it will be exhausted.

Mr. STUTZMAN. Did you look at if the payroll tax rates were not to be extended at the current levels, what kind of effect would that have on the economy? If we let Americans keep more of their money in their pocket, does that have any effect on the economy, positive or negative?

Mr. ELMENDORF. Yes, relative to current law extending the payroll tax cut for the end of the year will increase output and increase employment by the end of the year. I mean, in general, lower taxes or higher spending, in the short-term, given an economy with so many unused resources, those actions would tend to provide a boost in the short-term. The amount of the boost depends on the specifics of the policy, and the testimonies that we have done, including the one last fall, we tried to lay out what we estimate to be the relative bang for the buck of different sorts of policies, but the directions are pretty consistent. The crucial point to remember is that works for a few years in an economy with unemployed resources because the constraint on economic activity now is really the demand for goods and services.

By later in the decade, the constraint on their economic activity will be the supply of savings, it will be the later supply, it will be productivity, and in that sort of world, the way the budget choices matter is importantly through the amount of borrowing the government does, also through the effects of tax rates on people's behavior and through the effects of certain spending programs.

Chairman RYAN. Mr. Pascrell.

Mr. PASCRELL. Thank you Mr. Chairman. There was a sharp increase in military spending in 1943, guess why? So when you take numbers out of context and game the numbers, I think we all have a responsibility here to set the record clear. We have an entirely different situation.

Chairman RYAN. Who are you addressing?

Mr. PASCRELL. The gentleman from California just took off.

Chairman RYAN. The gentleman is not here.

Mr. PASCRELL. I will reduce my remarks about it, if that is okay with you. We had a very different situation in terms of President Bush I when you lowered taxes, and Mr. Clinton raised taxes. So if you want to put numbers in context and why things were better at one time and not so good at another time, we need all of the facts. Both of those presidents worked hard to do what was necessary at the particular time in history when they took office. This president took office in January of 2009, and you know what the employment and unemployment was in the two months before him, and in the two years before him, and in the two months after he raised his hand and in the two years after he raised his hand?

So I want to show you a chart, if I may.

We are gaming the numbers. The blue line in this chart shows the rate at which state and local government have been growing or shrinking as compared to real GDP since the late 1980s; it is very clear, even I understand it; so you all should understand it. Those are the numbers. You did not put them there, and I did not put them there. These are the numbers. In 2007, if you try to look closely, the private sector and government were growing, then the economy began to shrink and then fell off the cliff during the financial crisis which occurred at the end of 2008.

Can I see the second chart please?

Thank you. This chart shows the rate of government investments or how we are sacrificing the future as well as the present. At the beginning of 2009, in the face of political timidity and outright obstructionism, we acted to stem the drop in economic growth and unemployment, and we passed the Recovery Act, February of 2009. The most successful parts of the Recovery Act were state fiscal relief that went directly into state and local jobs. The result was the blue line's upward spike in 2009.

Then we all know the rest of the story. The private sector 2009 recovery stalled, and everything started to drop in the second quarter of 2010. The president proposed the American Jobs Act, which included $35 billion to reverse this trend, but it stalled in the Congress. We lose teachers, we lose police, and we lose firefighters. Now we have lost close to 700,000 in the public sector; so one is going up, and the other is going down dramatically.

Last night, so we could put a human touch on this, Mr. Elmendorf, police officer Kevin Brennan in Brooklyn was shot down, shot in the face pursuing an individual with an illegal gun. We have reduced, in human factors, when we glibly talk about what we can cut, and what we cannot cut. I mean, the direction we are going we are going to have to cut money to the FBI, transportation, border security, vets benefits because that is where we are headed. There are people here that want to destroy the government, and that it has no responsibility and they cannot live up to the obligations. Now, my question to you is this: In your opinion, was the effect of the elimination of thousands of public sector jobs, teachers, police, and firefighters, in overall economic growth to the economy?

Mr. ELMENDORF. No, Congressman.

Mr. PASCRELL. Why not?

Mr. ELMENDORF. The loss of public sector jobs is, as I said earlier, a part of the overall loss of jobs that we have seen in this very prolonged and severe economic downturn.

Mr. PASCRELL. We have seen that sector of the job market shrink.

Mr. ELMENDORF. Yes, Congressman.

Mr. PASCRELL. Thank you very much.

Chairman RYAN. Mr. Flores.

Mr. FLORES. Thank you, Mr. Chairman, thank you director Elmendorf for joining us today. Start out with a caveat to begin with. Economic growth is virtually the same as employment growth, right? I mean, if we talk about economic growth, we can talk about more people working.

Mr. ELMENDORF. They certainly move together, obviously not perfectly.

Mr. FLORES. Not perfectly, but pretty good correlation. So my question starts with this, and I would like to keep the answers fairly short. Which economic activity provides greater economic growth and employment, option A is private investment or option B is federal spending.

Mr. ELMENDORF. Congressman, it depends on the nature of the federal spending you have in mind.

Mr. FLORES. Well, I have a chart, I do not have it with me right now, but private investment is the correct answer. Private investment trumps federal spending almost every time. Which policy option provides greater economic growth, leaving a dollar in the hands of a taxpayer, or taking that dollar from that taxpayer and increasing federal spending?

Mr. ELMENDORF. Depends on the nature of the federal spending, Congressman. I am not trying to be difficult, but it does matter what money is used for.

Mr. FLORES. Okay. Well, let's put it this way then. What would create more jobs, Keystone XL pipeline or Solyndra? We spent about a half billion dollars on Solyndra, how many jobs do we have from that?

Mr. ELMENDORF. Congressman, we have not studied those particular examples.

Mr. FLORES. Not very many though, right?

Mr. ELMENDORF. Companies that fail generally do not create a lot of jobs, they do along the way, of course, and I have not tried to study the history of that firm.

Mr. FLORES. And how many federal dollars is it going to take to build the Keystone XL pipeline?

Mr. ELMENDORF. I do not know Congressman.

Mr. FLORES. Zero. And the estimates varies widely; some people say 20,000 temporary jobs, some people say it is just in the thousands, but it does not make any difference. On one hand, option A is Solyndra, where we spent a half a billion taxpayer dollars and got no jobs. On the other hand, we have $7 billion of private investment and we get good long-term economic job growth out of it, right?

Mr. ELMENDORF. Certainly a shortfall in private investment in the past years has been a drag on the economy during the past few years and will continue to be a drag on the economy over the decade. Part of the reason we say in that report that we have marked down the projection of GDP at the end of the decade, relative to

what we would have had without the financial crisis and recession, is a shortfall in investment.

Mr. FLORES. That takes us to my next question. In your opinion or in your agency's analysis, what is the optimum level of these activities as a percentage of GDP? Tax revenues, what is the optimum level at which you have good economic growth, you are not raising the deficit too high to cause long term damage, but at the same time you are taxing at an appropriate level to fund the government. What percentage of GDP is that?

Mr. ELMENDORF. I do not think there is an analytic answer to that question, Congressman, it is a matter of people's choices. Deciding the level of taxes that one thinks is appropriate cannot really be done separately from deciding the level of spending that one thinks is appropriate.

Mr. FLORES. Well that is my next question. So what is optimal? I mean, one of the things you have talked about here is the rub that we have, on one hand, you have said that the increase in tax rates that we are going to have on January 1st of next year is going to dampen economic activity, and it is going to have a pretty big dampening impact on economic activity.

On the other hand, you said that the deficits, which deficits are just transfer payments; they represent government spending and excess revenues; so you could call it a giant stimulus bill if you wanted. If you have a trillion dollars of deficits, it is really a trillion dollars of government stimulus. You said that stimulus is going to ramp up economic activity; if we turn that spending down it is going to lower economic activity. So what I am trying to get to is what the optimum percentage of tax revenues versus spending is? I mean, in the real world they ought to be the same, and I am just trying to get a feel for what that should be, and, again, as a percentage of GDP.

Mr. ELMENDORF. It certainly cannot be too far apart for too long.

Mr. FLORES. Right.

Mr. ELMENDORF. So the thing that cannot happen is that the ratio of our debt to our GDP rises indefinitely. That cannot occur because at some point, we cannot really predict when, but at some point people will stop lending that government money.

Mr. FLORES. Right. Let's go to the next one. What was the cost per job created under the stimulus spending, under the ARRA?

Mr. ELMENDORF. I am sorry, Congressman, I do not have an answer to that off-hand. We can take the estimate we have of the changes in employment, and divide that by the $837 billion, but I do not know off-hand what the answer to that would be.

Mr. FLORES. Okay. Well, it is substantial. It is a lot more than private dollar investment or the number of jobs you get for a private investment dollar spent. Lastly, you noted in your report that the cost of the stimulus has increased from $821 billion to $839 billion. What is behind that cost increase?

Mr. ELMENDORF. I think we made some small revisions to the cost of some of the refundable tax credits enacted in that legislation, and maybe on the unemployment insurance side as well: just the refundable, I am told. Some revision of the refundable tax credits.

Mr. FLORES. I guess the bottom line is the cost of the stimulus plan is still going up, and we do not have many jobs from it. Thank you.

Chairman RYAN. Mr. Honda.

Mr. HONDA. Thank you. Thank you very much. Thank you Mr. Chairman and welcome back.

Mr. ELMENDORF. Thank you, Congressman.

Mr. HONDA. I enjoyed that last discussion and congratulate your daughters coming to watch you work.

Mr. ELMENDORF. Thank you.

Mr. HONDA. I am sure they are going to learn something here. One of the things I have learned over the last couple years of being in this Budget Committee is that your job is to be neutral in your responses, and to respond in ways that are objective and honest and not be shaded by some the way we would like to lead our questions, and to have some sort of a response that appears to be favorable or unfavorable. I appreciate the difficulty of your task and I am awed at your grasp of the information that you have, having to respond to the different folks here.

Mr. ELMENDORF. Now you are going to stump me. You set me up.

Mr. HONDA. No, I am trying to just reflect my thinking on the kinds of things that we are trying to struggle with here in the Budget Committee on behalf of the country. I think every member of Congress agrees that we do have a deficit and a debt problem that deserves our serious attention. This attention should be looked at in terms of the dynamics of what has happened in the past, what could happen in the future, but how we put together the different policies and the mixture of that so that we try to figure out what is the best outcome in the future. We only disagree, I guess, about the best way on how to solve it, and I hope that we can really take a balanced approach and use a mix of the many tools at our disposals.

So in your initial gut reaction to a plan that has these kinds of characteristics, what was your reaction to having the plan that balances the budget by 2021, and makes a targeted investments in areas like infrastructure and education, and then finances these changes with a progressive tax code, and also ending our overseas military engagements? What would be your gut reaction to a plan that has those kinds of elements in it?

Mr. ELMENDORF. Congressman, I mean, we can and do analyze the economic effects of particular sorts of policies that Congress is considering. We have done quite a bit of this, for example, in terms of different tax policies that we have talked a little about today. We have also written about the value of certain sorts of government investments in physical capital, of a sort, of traditional sorts of highways and other infrastructure, but also in what economists call human capital, the skills of workers. That is harder to quantify, though. So we can talk about specific choices of that sort.

We have not been asked to analyze the effects of an overarching fiscal plan, except to the extent that we do an analysis every year of the president's budget, both the direct budgetary effects and the economic effects; and we have done an analysis in this outlook of this particular alternative scenario, which is not good in the long run. We have not looked at what you are talking about, exactly,

and we would have to know exactly what it was. But also, I want to emphasize that the reason that CBO does not make policy recommendations is because the policy choices are not just a matter of analysis. It is a matter, ultimately, of value judgments by you and your colleagues on behalf of me and my fellow citizens of what we want the government to do and not to do. I think the lesson of this alternative fiscal scenario and the size of the gap in 2022, and the fact that relative historical pattern we see there is so striking is the rise in the cost of Social Security and the health care programs.

The ultimate question will be whether we want to make, as a country, substantial cutbacks in Social Security and the federal health care programs, relative to how they are scheduled to work now, or substantial increases in tax revenue, relative to the historical experience. We have to pick at least one, we could do a combination of those two, we cannot do neither. We cannot sustain the traditional levels of tax revenue and the current benefits we provide for Americans when they become older at the same time, given the rising number of older Americans and the rising cost of health care. So any proposal that is set on one side of that or the other, has implications for the other side, and it is up to you and your colleagues to weigh those, and we can provide some analysis that I hope is helpful, but ultimately it is a matter of value judgments.

Mr. HONDA. Thank you, and I guess the analogy remains X equals whatever your value system is.

Mr. ELMENDORF. Thank you, yes.

Chairman RYAN. Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman, thank you Mr. Elmendorf. I am going to move away from the policy and get down into the weeds on some of the numbers if I can. If I could get that first slide up, that would be great; it's probably something that is just of interest to you and me, but let's take five minutes and go over some detail.

		January 2011 Forecast	*August 2011 Forecast*	*January 2012 Forecast*	*Variance*	*%*
2011						
	Real GDP	3.1	2.3	1.6	-1.5	-48%
	Nominal GDP	4.1	3.8	3.8	-0.3	-7%
	Inflation (CPI)	**1.3**	**2.8**	**3.3**	**2**	**154%**
	Unemployment	9.2	8.9	8.7	-0.5	-5%
					Revision	*%*
2012						
	Real GDP	2.8	2.7	2	-0.8	-29%
	Nominal GDP	4.3	4	3.3	-1	-23%
	Inflation (CPI)	**1.3**	**1.3**	**1.4**	**0.1**	**8%**
	Unemployment	8.2	8.5	8.9	0.7	9%

I was looking at the report last night, and noticed something fairly interesting regarding the inflation numbers, and it is something that you and I have talked about before, I have talked about

with Dr. Bernanke, a bunch of different folks. To run through the quick history, in your forecast of last year, you all expected inflation, and we're talking about the CPI now for urban workers, we can pick any measure you want, but we use them across this same analysis. You thought it would be 1.3 percent, then in August you adjusted that up to an assumption of 2.8 and then we finished the year at about 3.3.

At the same time that we saw in actual rates of inflation that were higher than your estimates, you did not change the assumptions for 2012, roughly the same: 1.3 last January, 1.3 again in August, and 1.4 in the report from yesterday. That grabbed my attention and it led me to the next slide, which I want to ask you about.

	Jan-11 Forecast	Aug-11 Forecast	Jan-12 Forecast	Avg 5-Year Rolling Avg Last 40 Years	Avg 5-Year Rolling Avg Last 10 Years	Best 5- Year Rolling Avg	Worst 5-Year Rolling Avg
1st 5-Year Window							
Inflation (CPI)	2	1.7	1.9	4.49	2.514	2.18	10.08
2nd 5-Window							
Inflation (CPI)	2.3	2.3	2.3				

We took a look at your projections for CPIU for the next five year window, the first five year window and the second five year window; they are slightly different, off by a year because of they are a rolling number, but let's call it the first year in the five year window. You have, despite the fact that inflation turned out to be considerably higher last year than you had expected, you actually revised down your expectations for inflation over the course of the first five year window, and left it the same for the second five year window. What we did, Mr. Elmendorf, was went in and looked at the historical data from the BLS since 1970, and took a series of five year rolling averages, and it turns out you are using an assumption for the first five year window in this report that would be the lowest five year rolling average in recorded history; and I am just wondering how you can justify that? If you take a look at what we have got: the average five year rolling average, which I know sounds strange, but I think you can see where I am going, over the last 40 years is almost 4.5 percent. The average five year rolling average over the last 10 years is 2.5 percent. The lowest we could find of any five year rolling average, going back to 1970, was actually 2006 through 2010, and that was still 2.2 percent, 2.18; and the worst, as Mr. Garrett referenced earlier in his questioning, was 1977 through 1981, when the average was above 10 percent. What is the justification in taking these unprecedented rates of inflation, as your assumption, as you look into the future?

Mr. ELMENDORF. I have not looked at those precise numbers, but I understand your point, I think, Congressman. You are certainly correct that our forecasts of inflation have errors in them like our forecasts of all other economic variables. In terms of last year, there were some particular developments in energy markets and other parts of the economy that pushed inflation above what we and many people have been expecting, and a number of people thought at the time that those were likely to be transitory developments, and the way the data are unfolding, is so far consistent with that story. So the change in the CPIU over the past three

months is less than it was over the past six months, which is less than it was over the past 12 months. The latest information about inflation suggests that it is in fact coming down.

Now, more broadly, I will mention two things. One is that, relative to years preceding the early 1980s, there has been a fundamental change in the behavior of central banks, in this country and around the world, related to a fundamental change in economists understanding of the role of central banks in keeping inflation down.

So as we look out to the second half of the decade, we think it is very clear that the Federal Reserve's objective is to keep inflation around 2 percent, and we think they have the tools to do that. For the next few years, I think the crucial thing to realize is that we have a period of unprecedentedly prolonged high unemployment since the Depression. We are living through a period that is the longest period of excess workers and houses and so on in the economy, that we have had in my lifetime, and there is a systematic relationship.

Mr. MULVANEY. And I do not mean to cut you off but I am running out time, and I may have to finish this in a second round, but I understand the relationship between GDP growth and the fact there is excess capacity in the labor markets, and that would allow us to grow the economy without seeing a lot of inflation, and this is the next slide, you all have actually revised up your GDP estimates over the course of the first five year window from 3.4 percent when we did this last January to 4.1 percent today, which again is well above the historical average and approaching the highest ever of the actual performance within the GDP growth in a five year window.

	1st Five Year Window	
	January 2011 Outlook	January 2012 Outlook
Real GDP	3.4	4.1
i% 3-month bill	3.6	2
i% 10 year note	4.7	3.8

So I guess my question is: How is it that you are assuming historic rates of growth and historically low rates of inflation?

Mr. ELMENDORF. The 15 second answer, Mr. Chairman, if I might, is that we are starting that growth from a particularly large gap between our actual output and the potential output of the economy. Then I am happy to take this up with you additionally, Congressman, later.

Mr. MULVANEY. Thank you, Mr. Chairman.

Chairman RYAN. Ms. McCollum.

Ms. MCCOLLUM. Thank you very much Mr. Chair. Dr. Elmendorf, it is good to have you here. I have two questions. They are rather brief and so I will give them to you together. Many Americans get up and go to work every day. More of them would like to be able to get up and go to work today, but Americans get up and go to work every day. They work hard and they contribute to the success

of our country. For every dollar of income from wages, these working Americans, they will end up, quite often, paying as much double the tax rate: double the tax rate of investors receiving income from dividends or capital gains. So to me this hardly seems fair. Since there is such a significant tax benefit, even a bias I would say, extended to investors over working Americans, is there some equitable, qualifiable benefit to the economy and job creation inherent in every dollar investors receive from dividends or capital gains, versus the dollar that is earned in wages? So what is the impact the federal deficit and this tax inequity and the benefits provided to investors over workers?

My second question I would like you to kind of summarize the different options because people have asked you a lot of questions, so you have some scenarios that you can talk about that you have presented to us. Again, all the Bush tax cuts are allowed to expire at the end of 2012, what is the effect on the economy and the federal deficit if only the upper end Bush tax and income earners over a million are allowed to expire, or if all the Bush tax cuts were extended for the next 10 years, what is the effect on the economy, what is the effect on the federal deficit? I have been struggling with this, you know, a worker who earns a dollar versus an investor who gets a benefit?

Mr. ELMENDORF. Congresswoman, as you know, in setting tax rates Congress takes a number of considerations into account. The equity issues are part of that, so is the effect on the economy and, you know, the economic effects are not necessarily correlated with what you or others might view as the justice of the situation, so it is really sort of a separate issue, and I am not qualified to speak to the equity issues, except in my own personal role.

When we do analysis of the effects of changes in tax rates, higher tax rates generally discourage the thing that is being taxed. Higher tax rates on work on balance, reduce work effort. Higher tax rates on the returns of saving, on balance reduces the amount of saving, and we incorporate those effects in the estimates that we do. I do not think there is a right answer from a economics perspective of what the relative tax rates should be because it is this combination of what the economic effects and value judgments again. We can do work about the effects of changes in the particular sorts of taxes, as can our colleagues and staff in the Joint Committee on Taxation, but I do not have comparisons of different sorts of things to use here.

On the second question you asked, the economic effects of extending all of the expiring tax provisions would be a little larger than the economic effects of extending all the expiring tax provisions, except for the top tax rates. So in the short-term the lower the taxes are in general and the higher spending is in general, that tends to boost the economy as I have said. Now an analysis we have done, before we have said that the effects of lowering the top tax rates is smaller on the economy in the short-term than the effects of changes in tax rates further down the income distribution because higher income people tend to spend a smaller share of the money that they have, and what the economy needs in the short-term is more spending. So the effects of extending the expiring tax rates at the top will be smaller, dollar for dollar, in the short-term in

stimulating the economy, than the effects of extending the other tax cuts.

In the longer term it is more complicated because in the longer term what matters, importantly, as I said, is not the demand for spending, it really is the supply of saving and the work effort and so on, and in the longer run it is more complicated actually to look at the effects of different sorts of changes in the tax rates, and we have some examples of this in the testimony I did for the Senate Budget Committee a year and a half ago, or so, and we talk more about that, but it is more subtle in the longer term.

Chairman RYAN. Thank you. Ms. Black.

Ms. BLACK. Thank you Mr. Chairman, and thank you Dr. Elmendorf for being here today. I want to turn our attention back to a subject that has been mentioned several times in the previous questions about trust funds, but more specifically about Social Security. In understanding trust funds and I think you have done a good job in the introduction to this particular section and I want to lift up one paragraph that is in there on Page 121 when you say, "A trust fund receives cash receipts that are not needed immediately to pay benefits or cover other costs, the Treasury uses the extra income to reduce the amount of new federal borrowing that is necessary to finance the government-wide deficit, and the reverse happens when revenues for trust fund falls short of the expenses in a given year." So I think that helps us to understand a little bit more about how the trust fund works. Then I want to turn everyone's attention to Page 122, and there just above the Social Security trust fund statement or section you say, "Without legislative action, that there are three trust funds are projected to be exhausted during that period," and that period you are talking about is 2013 to 2022: Social Security Disabilities, Insurance trust fund, Medicare hospital trust fund, and the highway trust fund.

Now, looking at Social Security trust fund, we know that it is running a cash deficit, and payments are going out for benefits that exceed the Social Security payroll taxes that are coming in, and of course, if this trend were to continue we would need to redeem the Social Security trust fund's assets to make payments. Do the Social Security trust funds represent real assets that government can draw upon?

Mr. ELMENDORF. So as we say Congresswoman, in the paragraph following the one you read, the balance in the trust fund is an asset for the individual program, but a liability for the rest of the government, and the resources to redeem a trust fund securities in some future year must be generated through taxes, income from other government sources, or borrowing from the public in that year. Therefore, trust funds have an important legal meaning in that their balances are a measure of the amounts the government has a legal authority to spend for certain purposes, but they have little relevance in an economic or budgetary sense.

Ms. BLACK. You say on Page 124 "By 2022 the trust fund for the Old Age and Survivor's Insurance is projected to show a deficit." What then? What then do we do? Do we go into the securities? Are there actual securities there that can be redeemed to pay for the benefit?

Mr. ELMENDORF. Well, there are actual securities there, the trust fund is the legal owner of a very large pile of honest to God government securities, but the resources to honor those has to come from some other place, as we have discussed, so when the trust fund starts to give securities back to the government, the rest of the government, and ask for cash, that cash has to come from some source in that year.

Ms. BLACK. And again, help me understand where they come from. You mentioned borrowing.

Mr. ELMENDORF. Basic sources of funds to the government on a unified basis all the time is the revenue that is collected, the taxes or fees or something else, and borrowing.

Ms. BLACK. So at the end of the day, it almost is a shell game where we just move this money around and it appears that in trying to understand when we tell people that are paying a tax, a payroll tax, and at the other end they expect a benefit, the dollars really that are being put in there, are not necessarily the dollars that, at the end of the day, are going to be redeemed because there is a lot of shifting and moving of the money?

Mr. ELMENDORF. How much people get out depends on the decisions of the Congress about future benefits. As you know, in CBO's work, we focus very much on the unified federal budget. The Social Security trust fund and others are accounting mechanisms and they have a useful role, I think, as accounting mechanisms, but in our analysis of the budget situation and our projections of the future budget, we focus on the outlays for programs and the collection of money without focusing on which particular account something is being kept track of in. We do talk about the trust funds in this appendix that you have read, but we think a more useful way for you and your colleagues to think about the fiscal policy choices, is not through the trust fund lens as much as in terms of the overall activities of the government, in both providing benefits and services, and in collecting revenue.

Ms. BLACK. I think, to make a point here, and I know my time is up, but I need to make the point here is that at the end of the day the money has to come from somewhere, and the money, if it starts to run out, has to come from somewhere, and i.e. many times that is borrowing more money and increasing our deficit.

Chairman RYAN. Thank you. Mr. Ryan.

Mr. RYAN OF OHIO. Thank you Mr. Chairman, thank you for all that you do for us and welcome to your family that is here.

Mr. ELMENDORF. Thank you.

Mr. RYAN OF OHIO. So, how many jobs do you guys estimate the stimulus bill created?

Mr. ELMENDORF. As a path over time, our estimate is that in 2010, for example, that it added between .7 and 3.3 million people in employment. In 2011, that it added between .5 and 2.6 million people in employment. In 2012, those numbers are smaller because the budgetary effects of the Recovery Act are waning.

Mr. RYAN OF OHIO. The money is coming out of the economy, or not going into the economy.

Mr. ELMENDORF. Not going into the economy.

Mr. RYAN OF OHIO. Right.

Mr. ELMENDORF. Yes.

Mr. RYAN OF OHIO. So we have CBO telling us that the stimulus has created millions of jobs here officially on the record. What was the change in GDP growth from, say, January and February prior to the stimulus bill? We know we were bleeding 600,000, 700,000 jobs a month. What was the change in GDP growth, say from that January and February to now, for example?

Mr. ELMENDORF. Well, as you know, GDP was falling very sharply at the beginning of 2009 and it reached its trough around the middle of the year, economists call that the end of the recession; recession is a technical term that means the declining period when GDP is declining. Since then GDP has been growing.

Mr. RYAN OF OHIO. By how many points from the bottom in that summer to the growth that we saw in the last quarter?

Mr. ELMENDORF. So I am sorry, I do not know that off hand.

Mr. RYAN OF OHIO. What did it grow last quarter, 2.8?

Mr. ELMENDORF. Yes.

Mr. RYAN OF OHIO. What was it in that summer? Do you remember, the negative?

Mr. ELMENDORF. I do not remember what it was in the first half.

Mr. RYAN OF OHIO. Okay, but we have had significant change. We have had jobs created. So one of my colleagues said earlier, you know, what is better, private investment and private investment trumps federal spending, and I do not think there is anybody here who would not rather have the private sector coming in, making investments, creating jobs; that is what we are all trying to figure out how to make that happen, and what environment needs to be in place in order for that to happen from deficits to investments that we make. But the issue really, at that point, was that there was not private investment, correct?

Mr. ELMENDORF. Yes, I think there was a very sharp reduction in household spending on the consumer goods, in housing construction, in business investment, and as private demand faltered, part of what happened in response to that was an automatic change in the government budget. Tax revenues fall when income falls, and spending rises when incomes are down, but also then the government acted through the Recovery Act and other measures, and we think that the Recovery Act provided some additional demand, some from government purchases, but some by lowering taxes in a way that boosted private demand.

Mr. RYAN OF OHIO. Did you run any models on what the world would have looked like had we not passed the stimulus package? At that point you guys had to have been saying, if you do a stimulus package that is 800 billion, if you do one that is 1.5 billion, or one 1.5 trillion, or if you do nothing, what was the model looking like of the do nothing scenario?

Mr. ELMENDORF. We did estimates in the winter of 2009 of the effects of the versions of the Recovery Act as they were being considered, and I think we published a chart at some point that showed a decline in the level of GDP that was very severe in the absence of the Recovery Act, and the decline that was still severe, but not as severe, in the presence of the Recovery Act. In a sense, one can take our estimates that we published now of the effects of the Recovery Act and subtract off those effects from the realized

GDP growth and employment levels, to get a sense of what we think would have happened in the absence of the Recovery Act.

Mr. RYAN OF OHIO. Okay, great. I just want to make that point. I mean, no one here is happy with where we are at today, believe me, I represent Youngstown, Ohio; we have the poorest city in the country. No one is happy with where we are at, but I think it is important for us to say wait a minute, there was no private investment, this had had some significant effect, CBO is telling us millions of jobs, a turnaround in GDP growth.

Last quick question, so now we are debating these value judgments of raising taxes on hedge funds, billionaires, millionaires, whatever, versus federal spending. What increases the GDP more significantly, a tax cut for a millionaire or higher, versus a federal investment in, say, building roads and bridges and fixing the combined sewer overflow problem we have in the country?

Mr. ELMENDORF. Over the next few years, Congressman, we think that higher income people spend a small share of the incremental income or wealth they have from a tax cut, does not provide very much stimulus to the economy relative to giving money to people who will spend a larger share of that money, and that includes sending money in the form of infrastructure investment. The big issue in that case, as I mentioned before, is the delay from your actions to the money actually flowing.

Chairman RYAN. Thank you. Mr. Ribble.

Mr. RIBBLE. Thank you Mr. Chairman. I do have a couple slides, I wonder if we can get those brought up. Dr. Elmendorf, thanks for being here, I know that it has been a long morning already. I appreciate your patience; you have been kind with your time. I want to take a look at two slides very briefly, and then just kind of get you to comment on them.

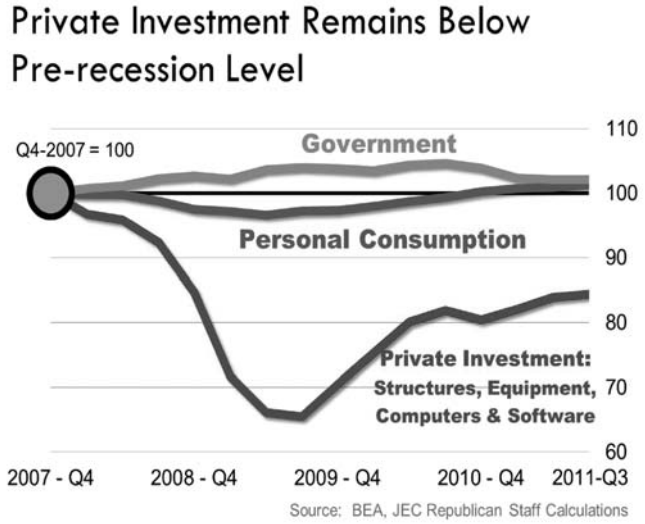
Consumer Spending Since 2001

This one shows consumer spending dating back to 2001. We can see the recession period in there, the drop-off in at consumer spending, but even that drop-off, it dropped off back to about 2007

levels, which was at the end of the housing boom, one of the largest growth periods in the nation's economy, and then subsequently it has turned around and began to grow again. I guess the thing that pops in my mind is we hear a lot about consumer spending. If consumer spending is the ticket to job growth, and consumer spending is up and up fairly dramatically from 2007, I wonder why we do not have jobs.

Mr. ELMENDORF. It is the sum of the demands for goods and services that drive overall employment; so it is adding up what is happening in consumer spending and business investment, and housing investment and the federal and state and local governments purchases of goods and services and net export.

Mr. RIBBLE. Good. Let me just bring another slide up. I am going to talk along the same lines. Let's go ahead and I will let you continue. I have got one more slide if we can bring that up.



All right, we have talked a lot, and my colleague did, Mr. Ryan from Ohio just mentioned it, you just mentioned in your comment, about private investment. I know that you are an economist, but I am going to ask you to put on your psychology hat, and can you possibly tell me because I spent 30 years in the private sector running my own business creating jobs in this country. I know that the political class here in Washington likes to claim they claim jobs, Democrats claimed all these jobs and Republicans create all these jobs. I find it a little insulting. I thought I actually helped create them myself in my company, but private investment is way off. Why do you suppose that is?

Mr. ELMENDORF. Well, investment is one of the more cyclically sensitive parts of the economy. So in general, business investment falls sharply in recessions and then rebounds sharply in recoveries, but it is true that in this particular downturn, business investment fell to an especially low level; we show a picture of that ourselves in our outlook I think. And there are a number of factors here, and it is hard to disentangle them. We are actually doing some work

now trying to disentangle various factors that have led to the slow recovery, and when that work is finished we will of course supply it.

Mr. RIBBLE. Let me tell you what small business owners and job creators are telling me back in my home district. They are telling me that they have absolutely no confidence that the political class in Washington, D.C. can solve these problems. Until they have a sense that we can solve the problems, until they have a sense that Democrats and Republicans can lay down their swords, maybe put aside preconceived impressions of reality, I have to defend this type of economic model, they have to defend their type of economic model and we are going to hold on to it until we die, business is not going to invest money because they do not trust us. I would call on all my colleagues to just lay down the sword and try to fix this thing, and inject some confidence back into the economy because I will tell you, the other thing I hear from them is that the government has gotten too much in the way. They feel that a $16 trillion debt, it scares the living daylights out of them. They feel that a regulatory environment that places thousands and thousands and thousands of pages and new rules on them every single year is a burden on them; and they feel that oppressive tax rates that continue to take from them money that they could use to create more and more jobs is a risk to them; and I hear this over and over again, not from just one or two.

I am going to close with one other comment, and one other question. I was really pleased to see that you brought your daughters with you today; I wish my own two children were here with me today and my grandchildren were here today. You have done a wonderful job, I am sure they are very proud of you. Do you think that their future is brighter today than it was $4 trillion of debt ago?

Mr. ELMENDORF. A lot has happened in the country since our debt was $4 trillion smaller, Congressman, and I think some aspects of that have been good for their future and some not, but that is a personal judgment in any case.

On the matter of business investment, I am not at all surprised that the uncertainty about future government policies is weighing on business. There is a recent paper, actually co-written by a member of our panel of economic advisers, that shows that uncertainty about government policies is especially high now, and given the tempering nature of so many parts of the tax code, such lack of clarity about what will happen in health care policy, in financial regulatory policy and so on, we think that is weighing on business investment decisions, but I would just say quickly, that I think the surveys of business suggest that the biggest factor weighing on their hiring and investing is uncertainty about the future demand for their products, and that is a sort of circular exercise, which is that if some businesses spent more and hired more, that would bolster demand for other business to work, and that would have a virtuous circle, but I think the biggest source of uncertainty that businesses face is their sales.

Mr. RIBBLE. And I completely agree with you, and I will tell you that regulations and taxes are affecting that demand. Thank you.

Chairman RYAN. Mr. Huelskamp.

Mr. HUELSKAMP. Thank you Mr. Chairman. Mr. Director, I appreciate your time today. I was looking through the report and on Page 36 you actually discuss participation in the labor force, and you note the employment rate in the fourth quarter of 2011 would have been one-quarter percentage point higher than the actual rate 8.7 percent. Trying to understand this, so when you factor in the number of people who quit looking for work, our effective unemployment rate is really to 10 percent?

Mr. ELMENDORF. Yes, I guess that is right. I cannot find the specific place, but yes. It is often the case in downturns that some people who lose jobs keep looking and some stop looking, at least for a while, but I think that effect has been particularly pronounced in this downturn, of course the rise in unemployment and the duration of high unemployment has been particularly pronounced as well.

Mr. HUELSKAMP. Yeah, it has been very difficult, but again, 10 percent effective unemployment rate, that still does not factor in the underemployed, that is correct, that does not include those?

Mr. ELMENDORF. I think that is right.

Mr. HUELSKAMP. Okay. If we factor those in, what percentage do we have of unemployed or underemployed?

Mr. ELMENDORF. I am sorry, I do not have that. That is an important concept, Congressman, I just do not have those numbers at hand.

Mr. HUELSKAMP. It certainly is and so I appreciate that. To follow up on that, my other question is turning to taxes, you have two scenarios, but if I do back of the envelope estimate is that if Congress does nothing we foresee at least a $5 trillion tax increase if the Bush/Obama tax cuts of 2001, 2003, and 2010 all expire, is that about $5 trillion over that 10 year window?

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

Mr. HUELSKAMP. Okay, and the net economic impact of a $5 trillion tax increase would be positive or negative?

Mr. ELMENDORF. Well, in the short run we think that that tax increase would have a negative effect on the economy. By the end of the decade, we think that that tax increase scheduled in current law would have a positive effect on the economy, and the reason is because the increase in tax rates embodied in current law has opposing effects on GDP over the medium-term and long-term. The lower tax rates do encourage additional work effort and saving in a way that we capture in our models, and that are good for the economy, but the tremendous amount of extra borrowing crowds out private investment, and that is bad for the economy. In our modeling, using a range of assumptions, the effects of the extra debt dominates the effects of the lower tax rates by the end of the decade.

Mr. HUELSKAMP. Even in the latter part of your comment about crowding other investments, you would say that even in light of Mr. Bernanke's statement that we are going to have massively low borrowing cost for the foreseeable future, and does that not play a significant role in trying to predict what would occur, and that is a question I will ask Mr. Bernanke openly in the next day or so?

Mr. ELMENDORF. Yes, and I am curious to hear his answer. Certainly the low borrowing cost is part of what we have in our base-

line projections, but it still may be the case, and we think it would be the case that relative to what would happen with a debt that was this big, having a debt of this big will raise interest rates, so that increase was coming from a lower baseline level than as often been the case, but we think that extra demand for credit will still push up the cost of credit.

Mr. HUELSKAMP. And another question, I appreciate that. I ask my staff regularly when they think the debt limit increase will be needed, and they have been saying it would be kind of March, but with the new higher deficit figures, another trillion dollars for the fourth year in a row, just unbelievable. What is your latest estimate for when the federal government will run out of money without using extraordinary means like is continually discussed?

Mr. ELMENDORF. So we do not try to track Treasury's cash flows on a monthly basis, so we are not the people to come to for a specific prediction at any point of when a date might be.

Mr. HUELSKAMP. I would say going to the Treasury for a specific prediction would be problematic as well. On the day they said they would run out of cash in August 2nd, they actually had another 10 days worth of resources. I appreciate that, but just big picture, will we get to 2013 or will we run out of money before a new president takes office?

Mr. ELMENDORF. So under current law, we think that, yes, the government can get to 2013 without raising the debt ceiling or going to the extraordinary measures that you mentioned, but that is quite uncertain. It depends on our economic projection; it also depends, of course, on the actions that Congress takes.

Mr. HUELSKAMP. Okay. I appreciate, and lastly, one quick question: last summer we had an exchange about which government programs created economic growth, went back and forth with your office, I know that is difficult to pull out, and looking at the effective unemployment rate of 10 percent, and the anemic economic projections, is it fair to say the tremendous run-up in government spending of 2009 did not benefit the economy in the long run?

Mr. ELMENDORF. The extra government spending from the Recovery Act in 2009 boosted the economy in the short-term, but we believe yes, unless there are offsetting changes made, that pay off the extra debt that was incurred, the economy will be worse off as a result by the time we get back to potential output and full employment later in the decade.

Chairman RYAN. Mr. Rokita.

Mr. ROKITA. Thank you, Mr. Chairman. Dr. Elmendorf welcome, thank you for being here. You and I always seem to talk about this time in the day. Part of being a new member, that is the last name with the letter "R."

Mr. ELMENDORF. Happy to be here.

Mr. ROKITA. I heard your testimony with the chairman, when you had a discussion about un-sustainability, and I heard you just say it is not Medicare, and I want to clear this up because this was my impression, it is not Medicare that is causing the un-sustainability, we have a mix of policies that need to be worked on.

Mr. ELMENDORF. Yes, I said what made the alternative fiscal scenario unsustainable in the long run, is the combination of policies, it is the growth, certainly, of Medicare, other federal health pro-

grams, Social Security set against taxes that remain close to their historical average share.

Mr. ROKITA. So I want to be clear, for the record, for my own understanding, for the American people, that you are not saying that we do not have to reform Medicare or are you? If we were to adjust all the other parts of that mix, and not touch Medicare, is this country okay in the long run?

Mr. ELMENDORF. So, in our projections from last summer for 2035, we have Medicare being about two percent of GDP larger than it is today, so that alone can be accommodated through other changes in policy. I do not think Medicare has to be changed over the next 25 years that we focus on here, but something has to be changed from current policies.

Mr. ROKITA. So seniors going on Medicare now might use it for the next 25 years, so I need a longer term view than that. I want to talk about my 2-year-old, my 4-year-old, I want to talk about their kids.

Chairman RYAN. Will the gentleman yield for a second? So just looking at the CBO's long term budget outlook, to answer your question because we have it right here, Medicare, Medicaid, the health care entitlements, plus the interest on debt at that time, will equal federal revenues. That means no other program in the federal government outside of the health care programs and the interest on the debt will be paid for by any revenues in 2034.

Mr. ELMENDORF. That is right, but as you know, the debt service that we are paying at that point arises from the combination of policies we have had in the intervening years. So again, I think it is a judgment that you all need to make about whether you want to have a country with historical levels of revenues and changes in Social Security, Medicare programs to come down to that level, or the programs as they are currently structured, and increases in revenues to come to up that level, or some combination of policies.

Mr. ROKITA. I just think when you are talking about a program that is going to be 14 percent of GDP and has no interest in plateauing from there; it is going to keep going and going; you have got to if you are going to have an honest discussion with us, the American peoples, understand that this is part, the centerpiece, perhaps, of the problem.

Mr. ELMENDORF. Again, Congressman, I think I have been very clear here and in many other times that it is the aging of the population and the rising cost of health care that is putting this unbelievable pressure on the federal budget, but there are different ways to respond to that and it is not our place to endorse.

Mr. ROKITA. Yeah, I understand that you said that a few times too, but when you say mix of current policies, you are endorsing something. That is what I want to be clear about, that Medicare reform is part of this mix, and that it has to be reformed or not. So that is what I want to get to.

Mr. ELMENDORF. Right, so I do not think that one can say that any single piece has to be reformed; it is the combination of policies that have to be pursued.

Mr. ROKITA. All right, well thatis on record. All right, let me go here. When Ms. Castor was asking you some questions about growing out of this deficit, I want to be clear for the record that you

mean to say that we can have policies that create growth, whatever we agree them to be, that could help reduce the deficit, that has nothing to do with reducing the debt. By definition, if you do not wipe out the deficit year to year, you cannot start attacking the debt; so you cannot grow your way out of the debt we are in, and the debt that is coming down the road alone. Just by growing the economy, all the dials not touched, you cannot grow your way out of this debt. In a first world mature economy.

Mr. ELMENDORF. In our baseline, our current law projections, debt continues to rise because we continue to have deficits, as you are saying, it falls slowly relative to GDP because the debt is rising more slowly than GDP by the second half of the decade under these current law projections.

Mr. ROKITA. But if you are eliminating the deficit, you are not reducing the debt.

Mr. ELMENDORF. You are not reducing the dollar value of the debt.

Mr. ROKITA. So growth alone will not do this. Regarding the extended payroll tax cut, I understood that the cost of the tax cut, if extended this year, would be about $100 billion, and you indicated that that is better for the near term economy than the Bush tax cuts.

Mr. ELMENDORF. Dollar for dollar that we estimate that lower payroll taxes has a stronger stimulative effect than a broad based.

Mr. ROKITA. And you also would agree that of that $100 billion has be paid for by future generations? But for our near term economic bump, other future generations need to pay for that?

Mr. ELMENDORF. Well, or this generation a few years later, but yes, it has to be paid for by somebody.

Mr. ROKITA. Right. With a small amount of time I have left, John Maynard Keynes, what do you believe he got right and what do you not subscribe to?

Mr. ELMENDORF. I think it is a widespread view among macroeconomists today that over the medium or long run, economies are what we call classical or neoclassical, so that the constraint on output and incomes is the supply of the factors of production, labor supply saving and so on, but also, I think, a view of most economists who are thinking about business cycles, is that in the short-term, then a very important determinant of the level of output and the level of employment is the demand for goods and services, and that is, at its heart, a Keynesian idea. The actual models we use, the way this is structured has evolved a tremendous amount in the 75 years, but that view that in the short run the economy has what people think of as Keynesian properties, in the medium and long run it does not have those Keynesian properties. That is, I think, a consensus view that you will find in leading textbooks. Not everybody shares it, I do not want to say that, but I think it is a consensus view that you will find in leading textbooks and a lot of the writings of people over the past few years, with a range of political views and a range of views about whether the right way to proceed in the country is to change taxes or spending and so on.

Mr. ROKITA. And my time is expired. Thank you. I will call the office from time to time.

Mr. ELMENDORF. Please do.

Chairman RYAN. Thank you, Mr. Woodall.

Mr. WOODALL. Thank you, Mr. Chairman, and thank you Dr. Elmendorf for staying with us throughout the morning. Just so you know, I tremendously appreciate the work you and your team does; I know we are here to talk about your latest body of work, but I want to talk a little bit about a publication you all do every so often, the Historical Effective Federal Tax Rates, just love this publication. As I turn to your most recent addition, I see this: that if you were in the bottom 40 percent of income earners in this country, you actually profit from the American income tax system. That almost half this country, and I am not talking about the refund check you get in April, I am talking about the tax code, the tax collection system in this country sends you more money than you send to it. The privilege of being American citizen is profitable through the income tax code for the bottom 40 percent of all Americans. I do not think we think about that, we all think that we are paying our fair share, that somebody else needs to pay a share. You know, I am a proponent of the fair tax, that is HR 25 here in the House, it abolishes the entire income tax code, and I look to your report that tells me for 40 percent of Americans, the income tax does not collect taxes, it distributes largesse. As evidence, the income tax code has lost its way.

I also look at your Trends in Federal Tax Revenues and Tax Rates, love that publication as well, and what I see, particularly when I combine with figure 4.1 from your economic outlook today, I look back during the Carter years, the Ford years, the 1970s, where the highest ordinary income rate in this country was 70 percent. The income tax rate was 70 percent in this country, but I look at your CBO baseline of revenues, and I see that revenues during that time were right there at historical averages, maybe a little lower. I fast forward to 1986 and the income tax reformsthat Tip O'Neill and Ronald Reagan put into place, I see the lowest ordinary individual income tax rates on record, but then I go to your figure 4.1 again, the CBO baseline, and I find out that during those years revenues were a little higher than the average revenues. So the higher tax rates lead to lower revenues, and the lower tax rates correspond to higher revenues; and as a freshman I appreciate you being able to educate me in that way.

What has really gotten me confused, though, is going back to figure 4.1, I see you have a CBO baseline projection and alternative fiscal scenario, and the alternative fiscal scenario assumes that President Bush's tax cuts, President Obama's tax cuts, all of those tax cuts stay in place. Is that correct?

Mr. ELMENDORF. All the expiring tax provisions are extended with the exception of the payroll tax.

Mr. WOODALL. So according to what I see here in figure 4.1, if we leave every single tax cut in place, in fact if we even bring back the tax cuts that expired in 2011, revenues will still be higher than the 50 year historical norm. We leave every tax cut in place, federal revenues will be higher in this 10 year window than the 50 year norm, am I reading that chart correctly?

Mr. ELMENDORF. By the end of the decade they would be higher than the average of the previous 50 years, yes. That is right Congressman.

Mr. WOODALL. But I have heard my colleagues talk about that revenue is an important component of our deficit crisis, and that the deficit is caused by these tax cuts, so I go to your CBO baseline proposal that assumes all of these tax cuts expire, and what I see is that if we allow these tax cuts to expire, federal revenues as a percent of GDP will rise to the highest levels in 50 years? Is that right? I only see a 50 year window here; it is the highest level on the chart. Is that correct?

Mr. ELMENDORF. It is the highest on the chart, I cannot speak to the longer history off-hand.

Mr. WOODALL. So if we allow those tax cuts to expire, and we allow federal revenues to rise to the highest level in 50 years, are we able to start paying down debt?

Mr. ELMENDORF. If the tax cuts expire, as under current law, and you keep to current law in spending, then the debt continues to rise.

Mr. WOODALL. So the highest tax rates over the last 50 years do not pay down any debt, but do they eliminate our annual deficits?

Mr. ELMENDORF. No, again, if the rest of current law remains in place, then we continue in our current law baselines, those continue to deficits.

Mr. WOODALL. If we allow all the tax cuts to expire, if we allow federal revenues to rise to the highest level in the last 50 years, we do not pay down a penny in debt, we do not eliminate our national deficit and we continue to accumulate that. What that tells me, Dr. Elmendorf, is that clearly revenues are not the challenge in this scenario, it is spending that is the problem and I know that folks back home are wondering when we allow revenues to rise to their highest levels in 50 years, what they are getting for that money.

Mr. ELMENDORF. But the short answer to that, Congressman, is there will be far more people collecting Social Security checks in 2022 than any point in the past 50 years. There will be far more people collecting Medicare benefits in 2022 than in the preceding 50 years. More elderly people collecting benefits for long-term care through Medicaid than in the preceding 50 years. So the American people are receiving benefits whether you and they view those benefits as worth that cost is the judgment that you and they have to make.

Mr. WOODALL. Well, I guess that goes to my colleague and Mr. Rokita's point, if we can allow revenues to rise to the highest level in 50 years, and that still does not solve the problem, we better focus on the spending side of the ledger. I appreciate your bringing that to us today, thank you again for spending so much time with us.

Mr. ELMENDORF. Thank you, Congressman.

Chairman RYAN. Thank you. Let me just conclude by just going to the outstanding work you do in your summer long-term budget outlook, which the June budget outlook, and I just simply want to impress upon the point that I think members here are trying to make, which we tried, at the beginning of the hearing. In 2034, using your numbers, spending on entitlement health care programs plus interest exceeds all federal revenues in 2034. In the end of the century, 2085, Medicare goes from where it is now, approximately

three percent of GDP to 14 percent of GDP. All health care entitlements, Medicare, Medicaid, CHIP and the exchange subsidies, just those programs right there exceed our revenue trend, so before the end of the century, before our kids and our grandkids are raising their families, all federal revenue that comes into the government will not be enough to cover our health care entitlements. Sure, I know you cannot give us policy recommendations or you do not give us policy recommendations or value judgments, it is obvious in your numbers that this path is unsustainable. I mean, we cannot just be a government that only provides health care benefits. We have national defense, we have education concerns, we have environmental concerns, we have Social Security, and so the sooner we recognize that the path we are on is ruinous, which is what you are showing us in these long-term numbers, the tax rates that you tell us that we need to have, if we want to finance this through income taxes: the bottom tax bracket is 25 percent, the middle income tax bracket is 66 percent, the top tax rate is 88 percent, we will not have an economy. Your own model breaks down, I think, in 2027 because of debt burdens. So I think we need to be a little more candid about the absolute un-sustainability of it and it is not simply a question of cutting back a little bit here on discretionary spending or trimming this program over here; this is all so unsustainable. It is the fault of both political parties and the sooner we recognize that the better off we are going to be, not only in keeping commitment to people who have organized their lives around these programs, but for our economy as well, and that is the point we are trying to make.

Mr. ELMENDORF. Mr. Chairman, as you know, you are fonder of our very long-term projections than we are when we talk with our panel of health advisers for their guidance in setting the very long term projections. They do not really talk with us about it, they think it is a silly question to ask, so we do provide them out the full 75 years, as the Social Security, Medicare actuaries do, we do the same thing for our long-term Social Security, Medicare projections, but if you look back 75 years ago, and picture what people in 1935 would have done in trying to project health spending in 2010, you can see why that is a very perilous business. So we try to focus, as we have, in this long-term budget outlook, on the next 25 years. What I think is there is an absolute trade-off between putting revenues above their historical average share of GDP and cutting Social Security and the federal health care programs.

Chairman RYAN. Are they being cut in real terms in what we are talking about, are rates of growth going down?

Mr. ELMENDORF. Let's actually be careful. Cut relative to what will occur under current law, and we said this, as you know, time and time again, that the Congress will need to either raise revenues well above what has been the historical average share of GDP, or make fundamental changes in the large entitlement programs, or some combination, even if one reaches for a combination, the changes to both revenues and these large entitlements will each need to be large because the scale of the problem, the gap between the revenues we are used to sending to the government and the benefits that we are used to getting from the government is getting so large.

Chairman RYAN. And the largest one is the health care entitlements, correct?

Mr. ELMENDORF. The fastest growing programs are the health care entitlements. Medicare is a little smaller than Social Security even 25 years from now, but Medicare and Medicaid together are larger than Social Security by the end of the decade.

Chairman RYAN. And this is why the point I tried to make earlier about getting better data in research and analytical tools on ideas and reforms on bending the cost curves of health care is really crucial because if we can get at the root cause of health inflation, that is one of the smartest, best things we can do to deal with this situation because I think as you have shown in your analysis the kinds of tax rates that this country would have to absorb, would be growth destroying if we actually went down that path.

Mr. ELMENDORF. And, as you know, that work is a very high priority for us.

Chairman RYAN. All right. Thank you.

Mr. HONDA. Mr. Chairman, if I may just have a closing comment also?

Chairman RYAN. Okay. I will get the last word, you know.

Mr. HONDA. Well, you are the chair. There are a couple comments I will make that I just needed to just respond to in terms of highest income in past 50 years, or expenditures that we see on the chart. The charts are kind of static in that we have to take them in the context of other dynamics. I think this is what is trying to be impressed upon by Dr. Elmendorf.

In terms of the highest income or highest expenditure in last 50 years, 50 years ago I was probably making around $200 a month, take home, and today, 50 years later, I have the highest income that I could ever have imagined or ever dreamed of, but it is because of the way the economy has changed, the cost of living has changed, and things like that, so to compare yesterday from today has to be taken in context of a lot of information. So in terms of numbers and budget and projection and things like that, the science and the art, if you will, of budgeting and trying to make the right decisions for the future and for our country has to be a thoughtful process, through dialogue and debate, and I think that that is why I appreciate today's session and, Mr. Chairman, you may have the last word.

Chairman RYAN. Okay. No, I am just having fun with you, but I actually will. It is a technical question I am going to have to ask you for the record. According to the March 2011 baseline, limiting spending to gas tax levels would result in spending that would be in average of $13 billion per year below current levels. Has that changed under the new baseline?

Mr. ELMENDORF. So that number is one, I think, is one I am not familiar with, but I can give you the current number.

Chairman RYAN. Okay.

Mr. ELMENDORF. We estimate, I think this is the answer to your questions which I was helpfully provided with late last night.

Chairman RYAN. That is, I think, why we are asked to ask you this right now.

Mr. ELMENDORF. Over the coming decade, we estimate on average annual outlays from the highway account, or the highway trust

fund, will be about $8 billion more than revenue and interest credited to the account, although of course that gap varies by year over the coming decade.

Chairman RYAN. So that is the change from last year's baseline to this year's baseline? What is the delta?

Mr. ELMENDORF. I do not have a number for last year, so I do not know what it used to be, all I know is what it is now.

Chairman RYAN. Okay.

Mr. ELMENDORF. And our current projection, on average, over the coming decade, between the outlays and revenues is $8 billion per year.

Chairman RYAN. Okay, okay, all right. I think that answers my question. Thank you.

Mr. ELMENDORF. Okay. Thank you all.

Chairman RYAN. The hearing is adjourned.

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

CHAIRMAN RYAN'S QUESTIONS SUBMITTED FOR THE RECORD AND THEIR RESPONSES

Changes in CBO's Estimated Impact of the 2009-Enacted Economic Stimulus Legislation

In a response to a question at our February 1, 2012 CBO Budget and Economic Outlook hearing, Director Elmendorf indicated that CBO estimates that the 2009-enacted economic stimulus legislation increased employment by between 0.7 million and 3.3 million people in 2010. The range he mentioned matches the low and high estimates for the legislation's employment impact in 2010 (calendar year average) published in CBO's November 2011 report on this subject (in the bottom portion of Table 1 on p 3.). I mention this because Table 1 in CBO's preceding August 2011 report displays an estimated employment increase of 1.3 million to 3.3 million people for 2010. In other words, as you know, CBO has significantly reduced the low estimate of employment increase due to the stimulus. More broadly, the November report (on page 8) confirms that CBO's low estimates of the stimulus legislation's effect on economic output and employment for each year are now smaller than its previous low estimates. A related footnote and Appendix in the November report reference a Valerie Ramey article "Can Government Purchases Stimulate the Economy?" published in the September 2011 volume of the American Economic Association's Journal of Economic Literature as part of the basis for CBO's reduced low estimates. The report's discussion on this is helpful, but it is difficult to get a complete picture of the size of the changes in CBO estimates for real GDP, the unemployment rate, and employment for each of 2009-2012. To do this, it is necessary to compare the Table 1 estimates in the November report with those in the August report.

Question: Can you provide a table that provides this comparison? In other words, a table that displays the low and high estimates and the differences between these estimates from the November 2011 and August 2011 reports of the stimulus legislation's effect on real GDP, the unemployment rate, and employment for each of 2009-2012 (calendar year averages)?

Answer: The first table below shows the change from August 2011 to November 2011 in CBO's estimates of the impact of the American Recovery and Reinvestment Act (ARRA) on output, the unemployment rate, employment, and full-time-equivalent employment. The related tables published in those reports are also reproduced below for your information.

As discussed with additional detail on page 8 of the November 2011 report, CBO's estimates of the impact of ARRA on output and employment differ from those CBO presented in August 2011 both because CBO adjusted its methodology for making such estimates and because CBO slightly revised its estimates of the timing of changes in federal spending as a result of ARRA.

On the basis of its continuing review of relevant research, CBO has decreased the lower end of its range of indirect multiplier effects from 1.0 to 0.5, while leaving the upper end of the range unchanged at 2.5. The indirect multiplier effect is applied to the direct effect of all changes in federal taxes and spending due to ARRA. As a result, CBO's low estimates of ARRA's effects on output and employment were smaller in November 2011 than in August 2011.

DIFFERENCE BETWEEN THE AUGUST 2011 AND NOVEMBER 2011 REPORTS

Estimated Macroeconomic Impact of the American Recovery and Reinvestment Act, 2009 to 2012
(difference in percentage points between the August and November 2011 Reports)

	Change Attributable to ARRA							
	Real Gross Domestic Product (Percent)		Unemployment Rate (Percentage points)		Employment (Millions of people)		Full-Time-Equivalent Employment (Millions)[a]	
	Low Estimate	High Estimate	Low Estimate	High Estimate	Low Estimate	High Estimate	Low Estimate	High Estimate
				2009 (Calendar Year Quarter)				
Q1	*	*	*	*	*	*	*	*
Q2	-0.4	*	0.1	*	-0.1	*	-0.2	*
Q3	-0.6	*	0.2	*	-0.3	*	-0.5	*
Q4	-0.8	*	0.3	*	-0.5	*	-0.7	*
				2010 (Calendar Year Quarter)				
Q1	-0.9	*	0.3	*	-0.6	*	-0.9	*
Q2	-0.9	*	0.4	*	-0.7	*	-1.0	*
Q3	-0.7	*	0.4	*	-0.7	*	-1.0	-0.1
Q4	-0.5	*	0.3	*	-0.6	*	-0.9	*
				2011 (Calendar Year Quarter)				
Q1	-0.6	*	0.3	*	-0.6	*	-0.8	-0.1
Q2	-0.4	*	0.3	*	-0.5	*	-0.7	*
Q3	-0.4	-0.1	0.2	*	-0.4	-0.1	-0.6	-0.1
Q4	-0.2	0.1	0.2	*	-0.3	*	-0.4	*
				2012 (Calendar Year Quarter)				
Q1	-0.1	0.1	0.1	*	-0.2	*	-0.3	*
Q2	-0.2	*	0.1	*	-0.2	*	-0.2	*
Q3	-0.2	*	0.1	*	-0.2	*	-0.2	*
Q4	-0.1	*	0.1	*	-0.1	*	-0.1	*
				Calendar Year Average				
2009	-0.5	*	0.1	*	-0.2	*	-0.3	*
2010	-0.8	*	0.4	*	-0.7	*	-1.0	*
2011	-0.4	-0.1	0.3	*	-0.5	*	-0.6	-0.1
2012	-0.1	*	0.1	*	-0.2	*	-0.2	*

Source: Congressional Budget Office.

Note: * = Between -0.05 and 0.05.

a. A year of full-time-equivalent employment is 40 hours of employment per week for one year.

TABLE 1 FROM THE NOVEMBER 2011 REPORT

Table 1.

Estimated Macroeconomic Impact of the American Recovery and Reinvestment Act, 2009 to 2012

	Change Attributable to ARRA							
	Real Gross Domestic Product (Percent)		Unemployment Rate (Percentage points)		Employment (Millions of people)		Full-Time-Equivalent Employment (Millions)[a]	
	Low Estimate	High Estimate	Low Estimate	High Estimate	Low Estimate	High Estimate	Low Estimate	High Estimate
2009 (Calendar Year Quarter)								
Q1	*	0.1	*	*	*	*	*	0.1
Q2	0.4	1.4	-0.1	-0.3	0.1	0.5	0.2	0.7
Q3	0.6	2.5	-0.2	-0.6	0.3	1.2	0.4	1.7
Q4	0.7	3.4	-0.3	-1.1	0.5	1.9	0.7	2.8
2010 (Calendar Year Quarter)								
Q1	0.9	4.4	-0.3	-1.5	0.6	2.7	0.9	4.0
Q2	0.8	4.6	-0.4	-1.8	0.7	3.4	1.0	4.9
Q3	0.7	4.1	-0.4	-2.0	0.7	3.6	1.0	5.2
Q4	0.6	3.5	-0.3	-1.9	0.6	3.5	0.9	5.0
2011 (Calendar Year Quarter)								
Q1	0.6	3.1	-0.3	-1.8	0.6	3.3	0.8	4.6
Q2	0.4	2.5	-0.3	-1.6	0.5	2.9	0.7	4.0
Q3	0.3	1.9	-0.2	-1.3	0.4	2.4	0.5	3.3
Q4	0.2	1.5	-0.2	-1.1	0.3	2.0	0.4	2.6
2012 (Calendar Year Quarter)								
Q1	0.2	1.1	-0.1	-0.8	0.3	1.6	0.3	2.0
Q2	0.1	0.9	-0.1	-0.7	0.2	1.2	0.2	1.5
Q3	0.1	0.7	-0.1	-0.5	0.2	1.0	0.2	1.1
Q4	0.1	0.6	-0.1	-0.4	0.1	0.8	0.1	0.8
Calendar Year Average								
2009	0.4	1.8	-0.1	-0.5	0.2	0.9	0.3	1.3
2010	0.7	4.1	-0.4	-1.8	0.7	3.3	0.9	4.7
2011	0.4	2.2	-0.2	-1.4	0.5	2.6	0.6	3.6
2012	0.1	0.8	-0.1	-0.6	0.2	1.1	0.2	1.3

Source: Congressional Budget Office.

Note: * = Between -0.05 and 0.05.

a. A year of full-time-equivalent employment is 40 hours of employment per week for one year.

TABLE 1 FROM THE AUGUST 2011 REPORT

Table 1.

Estimated Macroeconomic Impact of the American Recovery and Reinvestment Act, 2009 to 2012

	Change Attributable to ARRA							
	Real Gross Domestic Product (Percent)		Unemployment Rate (Percentage points)		Employment (Millions of people)		Full-Time-Equivalent Employment (Millions)[a]	
	Low Estimate	High Estimate	Low Estimate	High Estimate	Low Estimate	High Estimate	Low Estimate	High Estimate
				2009 (Calendar Year Quarter)				
Q1	0.1	0.1	*	*	*	*	*	0.1
Q2	0.8	1.4	-0.2	-0.3	0.3	0.5	0.4	0.7
Q3	1.2	2.5	-0.3	-0.6	0.6	1.2	0.9	1.7
Q4	1.5	3.4	-0.5	-1.1	0.9	1.9	1.4	2.8
				2010 (Calendar Year Quarter)				
Q1	1.8	4.4	-0.7	-1.5	1.3	2.8	1.8	4.0
Q2	1.7	4.6	-0.8	-1.9	1.4	3.4	2.0	4.9
Q3	1.4	4.1	-0.8	-2.0	1.4	3.6	2.0	5.2
Q4	1.1	3.5	-0.7	-1.9	1.3	3.5	1.8	5.0
				2011 (Calendar Year Quarter)				
Q1	1.1	3.2	-0.6	-1.8	1.2	3.3	1.6	4.7
Q2	0.8	2.5	-0.5	-1.6	1.0	2.9	1.4	4.0
Q3	0.7	2.1	-0.5	-1.3	0.8	2.5	1.1	3.4
Q4	0.4	1.4	-0.3	-1.1	0.6	2.0	0.8	2.6
				2012 (Calendar Year Quarter)				
Q1	0.3	1.0	-0.3	-0.8	0.5	1.5	0.6	2.0
Q2	0.3	0.9	-0.2	-0.6	0.4	1.2	0.4	1.4
Q3	0.3	0.7	-0.2	-0.5	0.3	1.0	0.3	1.1
Q4	0.2	0.6	-0.1	-0.4	0.3	0.8	0.2	0.8
				Calendar Year Average				
2009	0.9	1.9	-0.3	-0.5	0.5	0.9	0.7	1.3
2010	1.5	4.2	-0.7	-1.8	1.3	3.3	1.9	4.8
2011	0.8	2.3	-0.5	-1.4	0.9	2.7	1.2	3.7
2012	0.3	0.8	-0.2	-0.6	0.4	1.1	0.4	1.3

Source: Congressional Budget Office.

Note: * = Between -0.05 and 0.05.

a. A year of full-time-equivalent employment is 40 hours of employment per week for one year.

Highway Trust Fund

Question: The January 2012 baseline estimates the Highway Trust Fund (HWTF) is now set to become insolvent in 2013 instead of the second half of 2012. What is the reason for this brief reprieve and does it materially change the financial status of the Highway Trust Fund (including both the Highway and Transit accounts)?

Answer: CBO's January 2012 estimates of Highway Trust Fund (HWTF) spending and revenue include minor technical changes from our earlier estimates related to the expected pace of spending and the collection of revenues. For example, in August 2011, CBO estimated that the trust fund would have a balance of about $9 billion at the end of fiscal year 2012, while our January 2012 baseline reflects an estimated balance of $12 billion at the end of the current fiscal year. The changes between the August and January projections do not materially alter the fundamental disparity between projected revenues to the fund under current tax rates and projected spending if annual obligations are continued at the current level. Spending from the fund totaled about $45 billion in fiscal year 2011, while revenues deposited into the fund last year totaled about $37 billion.

Question: On May 17, 2011, CBO Assistant Director for Microeconomic Studies, Joseph Kile, testified before the Senate Finance Committee stating that limiting spending in the Highway Trust Fund (including both the Highway and Transit accounts) to the amount that is collected in current taxes on fuel and other transportation activities would result in spending that would be about $13 billion per year below the current amount. Has this estimated average changed under the January 2012 baseline?

Answer: No, that estimate has not changed appreciably. Under CBO's January 2012 baseline estimates, projected spending from the HWTF would be greater than the revenues credited to it by around $13 billion a year over the 2012-2022 period. But because the HWTF is not authorized to borrow additional funds or incur a deficit, that level of spending cannot be sustained in after 2013, according to CBO's estimates of fund revenues and spending.

Question: If Congress did limit spending to gas tax revenue in the Highway Trust Fund, how much lower, on average, would annual spending be below the current amount in the Highway Account? What about the Transit Account?

Answer: Over the 2012-2022 period, spending from the highway account would need to be at least $9 billion lower each year and spending from the transit account would need to be at least $5 billion lower each year—relative to the baseline extrapolation that assumes that future annual obligations from those accounts remain constant in real terms. Those projected reductions in spending incorporate the need for the Department of Transportation to maintain a cash balance in the HWTF in order to meet obligations in a timely manner.

Student Loans

In 2007, the College Cost Reduction and Access Act (CCRA) became law which temporarily lowered, for four years, subsidized Stafford student loan rates from 6.8% to 3.4%. Some in Congress are calling for a continuation of this lower rate that is set to expire later this year. I have some questions about this last-minute call for action.

Question: Does the January 2012 baseline reflect this coming increase in interest rates?

Answer: Yes, the January 2012 baseline reflects the scheduled increase in interest rates because that increase will occur under current law.

Question: Did any of the "savings" associated with the shift to 100% direct lending in the Health Care and Education Reconciliation Act of 2010 come from the assumption that interest rates would rise to 6.8% later this year? If so, how much?

Answer: None of the savings in CBO's estimate of the budgetary impact of moving student loans to 100-percent direct lending came from the scheduled increase in interest rates. At the time that the Health Care and Education Reconciliation Act was being considered by the Congress, that scheduled rate increase was already included in the baseline for both the guaranteed loan and direct loan programs; thus, moving to 100-percent direct lending did not affect those interest rates.

Question: Since most of the "savings" in the Health Care and Education Reconciliation Act of 2010 went to offset the cost of the Pell program and other new spending. Is it fair to say that the savings generated from the 6.8% interest rate have already been spent?

Answer: Public Law 107-139, which set a fixed interest rate of 6.8 percent on all newly disbursed Stafford loans (both subsidized and unsubsidized) beginning on July 1, 2006, was enacted in February 2002. Henceforth, following the law, CBO's baseline included that 6.8 percent interest rate for all Stafford loans (guaranteed and direct) after July 1, 2006. The College Cost Reduction and Access Act (CCRA) temporarily lowered that rate for five years for new subsidized Stafford loans made to undergraduate students; under the CCRA, that lower rate does not apply to new loans disbursed on or after July 1, 2012. Therefore, all of CBO's baseline projections following enactment of CCRA have reflected the scheduled increase in interest rates to 6.8 percent for new subsidized Stafford loans disbursed on or after July 1, 2012. Accordingly, none of the savings in the Health Care and Education Reconciliation Act of 2010 were related to that scheduled increase.

Question: How much would it cost to continue the 3.4% interest rate for one year? What about for four more years?

Answer: Under CBO's January 2012 baseline, we estimate that extending the interest rate of 3.4 percent for one year would cost about $5.9 billion over the 2012-2022 period (with most of that cost falling in fiscal years 2012 and 2013). Under the January 2012 baseline, we estimate that extending the interest rate of 3.4 percent for four years would cost about $19 billion over the 2012-2022 period (with most of that cost falling in the first half of that period).

Poverty Trap

Question: This question pertains to antipoverty programs and their potential impact on work incentives. Outside analysis has shown that for lower-income individuals at certain segments of the earnings scale (i.e. between $15,000 and $30,000) there can be a financial disincentive to work. For instance, as these individuals earn

more income, their transfer payments and subsidies from the government (i.e. EITC, food stamps, housing vouchers, etc.) decline and their marginal tax rates jump. As a result, after-tax income plus government transfers and subsidies may actually stay flat or even fall for some individuals as their earnings increase. This disincentive to work and earn more has been dubbed "the poverty trap." Can CBO do an analysis which shows (in chart form) earned income less taxes plus government transfers and subsidies for a few hypothetical households (e.g, a family of 3 and a single mother) as these households move up the earnings scale?

Answer: Low-income individuals and families may be eligible to receive cash or in-kind assistance through various government transfer programs. In addition, they may also be able to claim refundable tax credits. With refundable credits, eligible individuals receive the entire amount of the benefit even if it exceeds the income tax liability they would have otherwise. Both transfer programs and refundable tax credits increase an individual's or family's resources.

Over some earning ranges, the amount of a transfer or a refundable tax credit neither rises nor falls as income increases. But over other earning ranges, transfer or credit amounts do rise or fall. Because the refundable earned income tax credit (EITC) and the partially refundable child tax credit initially increase as earnings rise, those provisions reduce marginal tax rates for very low-income workers and may encourage work. However, to reduce the cost to the government of various tax credits and transfer programs, benefits often limit eligibility to individuals and families with incomes below a threshold or phase out as earnings continue to rise. Those phaseouts increase effective marginal tax rates and may reduce incentives to work—as do payroll taxes and, in some cases, state income taxes that people owe as their earnings rise.

The phaseouts of transfer programs do not affect marginal tax rates of all low-income families. Not all families are eligible for those transfer programs, and not all eligible families participate in the programs. Data from a nationally representative household survey show that the majority of working families headed by non-elderly and non-disabled individuals with incomes below 250 percent of the federal poverty level (FPL) do not receive a means-tested transfer—and, of those who do, the majority participate in only one program (see Table 1). Although program participation tends to be underreported in survey data, researchers using administrative data have also found low rates of participation in multiple programs among low-income working families.[1]

CBO calculated the relationship between a family's earnings and its disposable income—the income it has after paying taxes and receiving government transfer benefits—as earnings increase from zero to 250 percent of the FPL. Figures 1 to 3 display that relationship for three hypothetical families in 2012: a single parent with one child, a married couple with two children, and a single person without children.

In this analysis, taxes include federal income taxes, state income taxes, and the employee's share of payroll taxes (calculated at the temporary lower rate in effect for 2012). The transfer programs used in the analysis include Temporary Assistance to Needy Families (TANF), Housing Choice Vouchers, and the Supplemental Nutrition Assistance Program (SNAP).[2] Because participation in SNAP is more common than participation in TANF, the following examples show disposable income for families that participate only in SNAP (panel A of each figure) and for families that participate in all three programs (panel B of each figure).

The figures show that:

• For either a single parent with one child or a married couple with two children, transfer programs and refundable tax credits initially raise disposable income above earnings—especially for families with very low earnings who receive TANF and housing vouchers. The change in disposable income associated with an increase in earnings fluctuates because tax and transfer benefits phase in and phase out at varying rates across the range of earnings.[3] For earnings between about 100 percent

[1] See Stephen D. Holt and Jennifer L. Romich, "Marginal Tax Rates Facing Low and Moderate Income Workers Who Participate in Means-Tested Social Programs," National Tax Journal, vol. 60, no. 2 (2007), pp. 253-276.

[2] CBO calculates disposable income using Pennsylvania's state income tax rates and TANF rules because its income tax rates and rules for means-tested transfer benefits are similar to those found in other states. CBO also uses the median housing costs and median family incomes in Pennsylvania in estimating transfer benefits, where relevant. In Pennsylvania, households with gross incomes below 160 percent of the FPL are eligible for SNAP.

[3] Sharp drops in disposable income can occur when earnings rise above thresholds for eligibility for certain transfer programs, because once earnings exceed the threshold, the benefit ceases. If, however, benefits phase out completely before earnings reach the threshold, disposable income changes gradually as earnings cross that threshold.

and 150 percent of FPL, disposable income increases very little (and in some ranges not at all) as earnings increase, because tax and transfer benefits phase out.

• As earnings rise above 150 percent of the federal poverty level, disposable income falls below earnings because income and payroll tax liabilities (before credits are included) exceed the sum of transfer payments, the EITC, and child tax credits. (After families stop receiving the transfer payments, either because they lose eligibility or benefits phase out completely, disposable income is the same as after-tax income.)

• In contrast, because the EITC for a single person without children phases in at a lower rate and has a smaller maximum amount than for taxpayers with children, the EITC only slightly boosts disposable income above earnings. In particular, because of the temporarily lower payroll tax rate in 2012, the EITC exceeds payroll taxes over a narrow range of earnings. Taxpayers without children are eligible for SNAP and housing vouchers, which raises their disposable income, though their benefits from these programs are generally less than those of larger families.

[Whereupon, at 12:35 p.m., the Committee was adjourned.]

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