THE CONGRESSIONAL BUDGET OFFICE'S BUDGET AND ECONOMIC OUTLOOK

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

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THE CONGRESSIONAL BUDGET OFFICE'S BUDGET AND ECONOMIC OUTLOOK

WEDNESDAY, FEBRUARY 13, 2013

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

The committee met, pursuant to call, at 10:17 a.m. in room 210, Cannon House Office Building, Hon. Paul Ryan [chairman of the committee] presiding.

Present: Representatives Ryan of Wisconsin, Price, Garrett, Campbell, Cole, McClintock, Lankford, Black, Flores, Rokita, Woodall, Blackburn, Nunnelee, Renacci, Rigell, Hartzler, Walorski, Messer, Rice, Williams, Van Hollen, Schwartz, Pascrell, Ryan of Ohio, Moore, Castor, McDermott, Lee, Cicilline, Jeffries, Pocan, Lujan Grisham, Huffman, Cardenas, Blumenauer, and Schrader.

Chairman RYAN. If Dr. Elmendorf could take his usual and customary position. Kind of feels like Groundhog Day sometimes, doesn't it?

Mr. ELMENDORF. Yes.

Chairman RYAN. Let me start this hearing, first off, by welcoming our new members. We have got a lot of new members who cover a big cross-section of this country, who represent different areas, different views, different philosophies, and I just want to first start off by saying how much of a pleasure it is to serve on this committee. This is the kind of committee where you get to bring your ideas to the table and air them out. We have got enormous fiscal challenges ahead of us. We have got a debt problem that we all acknowledge must be dealt with. We have got a deficit that needs to be brought down. We have got an economy that needs growth, and this is one of those areas, one of those committees where we need to have this debate.

We are going to be processing legislation. We are going to be considering alternatives, and I just want to say on behalf of those of us here on this side of the aisle, we look forward to engaging our friends on the other side of the aisle in the collegial way and comity way we have, and it will be a good, vigorous debate. And this is what the country deserves.

I mean, with that, welcome everybody to today's hearing. Thanks, again, Dr. Elmendorf, Doug, for coming and testifying, and I want to thank you for your staff for putting together the latest budget and economic outlook. We understand you had a bit of a time crunch given the end-of-the-year episodes that occurred, and I wanted to say that you didn't miss much of a deadline, and you put out your baseline and outlook in a fairly quick form, given the circumstances that you had to contend with.

I am sorry to say, though, that things don't look good. The CBO says that our economy will grow by only 1.4 percent this year. Unemployment will hover around 8 percent this year, and we will add another trillion dollars to our debt. That is the news we just received from the CBO.

Further down the road, things get worse. The CBO says we will add $10 trillion to our total debt by the end of the budget window. That debt will weigh down our economy like an anchor. Starting in 2019, the economy will grow by a mere 2.2 percent, much, much lower than the historical average. And when people can't find jobs, many stop looking altogether for work. In other words, this report is a warning of what is to come if we don't get spending under control.

Publicly-held debt will hit 76 percent of GDP at the end of this year. That is the largest share of debt since 1951. In the 1950s, we paid down our debt. And our economy kicked into high gear. These days, we still haven't gotten a handle on spending. Total debt already exceeds 100 percent of gross domestic product. You see, we are in the danger zone.

Economists from the right and left say that if you get your total debt at that area, you really go into the danger zone. Investors might begin to doubt our ability to pay our obligations. They might demand higher interest rates. As we know on this committee, if they did that, interest rates across the country would skyrocket, on mortgages, on credit cards, on car loans. One estimate says that an interest rate increase of a single percentage point will cost the average family $400 more each and every year.

In short, we could have a debt crisis. And the result of a debt crisis would be catastrophic, because unlike during the financial crisis, government would be unable to borrow more money. Instead, the only way out to be austerity, which we are witnessing in Europe; big tax hikes and big spending cuts. Interest goes up. We literally start losing control of our own fiscal situation. We become slaves to interest on the debt. We don't have to look far for examples of a debt crisis in action.

We don't even have to look at Europe. In Central Falls, Rhode Island, retirees' pensions have been slashed by up to 55 percent. In Stockton, California, a quarter of the police force has been laid off. If a debt crisis hit this country, the social safety net would unravel. The most vulnerable would suffer, and we cannot let that happen. This is our obligation here in this committee. And if this report shows us anything, it is that, primarily, spending is the problem. Spending on Medicare and Social Security is set to double. Spending on interest is set to quadruple. The CBO expects revenue to double in the next 10 years, so taxes are going up. Revenue is rising. It is doubling. But even with the President's tax hikes the budget never, ever, ever balances. In fact, it doesn't even come close.

By 2023, the deficit will be nearly $1 trillion, just like it is today. The President says we need a balanced approach to closing the deficit, by which he seems to mean one tax hike after another. But the fact is, mathematically, we can't tax our way out of this problem. We need to get serious on spending. And unfortunately, the President has yet to produce a budget. It was due last week. In violation of the law, it has yet to be received by Congress. And Senate Democrats haven't passed a budget in nearly 4 years. Hopefully that will change.

We will offer our budget here in the House on time, next month, in accordance with the law. We will put our plan up against the President's, and we will have a healthy debate in the House over the way forward.

[The prepared statement of Chairman Ryan follows:]

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

Welcome, everyone, to today's hearing. Thanks to Dr. Elmendorf for coming to testify. And thanks to your staff for putting together the latest Budget and Economic Outlook.

I'm sorry to say: Things don't look good. The CBO says our economy will grow by only 1.4 percent this year. Unemployment will hover around 8 percent. And we will add another trillion dollars to our debt.

Farther down the road, things get worse. The CBO says we will add $10 trillion to our total debt by the end of the budget window. That debt will weigh down our economy like an anchor. Starting in 2019, the economy will grow by a mere 2.2 percent—much lower than the historical average. And when people can't find jobs, many will stop looking altogether.

In other words, this report is a warning of what's to come—if we don't get spending under control.

Publicly held debt will hit 76 percent of GDP at the end of this year—the largest share since 1951. In the 1950s, we paid down our debt—and our economy kicked into high gear. But these days, we still haven't gotten a handle on spending. Total debt already exceeds 100 percent of GDP.

We're in a danger zone. Investors might begin to doubt our ability to pay our obligations. They might demand higher interest rates. If they did, interest rates across the country would skyrocket—on mortgages, on credit cards, on car loans. One estimate says an interest-rate increase of a single percentage point would cost the average family $400 more each year.

In short, we would have a debt crisis. And the results would be catastrophic—because unlike during the financial crisis, government would be unable to borrow more money. Instead, the only way out would be austerity: big tax hikes and big spending cuts.

We don't have to look far for examples of a debt crisis in action. In Central Falls, Rhode Island, retirees' pensions have been slashed by up to 55 percent. In Stockton, California, a quarter of the police force has been laid off. If a debt crisis hit the country, the social-safety net would unravel. And the most vulnerable would suffer. We can't let that happen.

And if this report shows us anything, it's that spending is the problem.

Spending on Medicare and Social Security is set to double. Spending on interest is set to quadruple. The CBO expects revenue to double in the next ten years. But even with the President's tax hikes, the budget never balances. In fact, it doesn't come close. By 2023, the deficit will be nearly $1 trillion.

The President says we need a "balanced" approach to closing the deficit—by which he seems to mean one tax hike after another. But the fact is, we can't tax our way out of this problem. We need to get serious about spending.

Unfortunately, the President has yet to produce a budget—in violation of the law. And Senate Democrats haven't passed a budget in nearly four years.

House Republicans will offer their budget—on time—next month. We will put our plan up against the President's. And we will have a healthy debate in the House over the way forward.

With that, I yield to the ranking member, Mr. Van Hollen.

Chairman RYAN. With that, I would like to yield to the ranking member for his opening comments.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. I want to join the chairman in welcoming Dr. Elmendorf, and thank you and your team at the Congressional Budget Office for the professional work that you do.

Just at the outset, let me say with respect to the timing the President's budget submission. I think all of us who were part of the last Congress know that we struggled until January 2nd to pass legislation to avoid the fiscal cliff. The result of that legislation was to make sure that we did not see a sharp increase in taxes on middle-income Americans, but we asked higher-income individuals to begin to contribute to reducing the debt over the long term.

As CBO has said, that that action did help strengthen the economy. If we had actually gone over the fiscal cliff, we would be in a world of hurt, but it did take us until January 2nd, to do it, and we didn't know how much revenue would be coming in either this year or in the next 10 years. So it is understandable that the President needs a little more time on the budget.

Look, as the Budget Committee, our challenge is to try and come up with a blueprint for our country's decisions on spending and taxes. And while we talk a lot about numbers, ultimately it should be a reflection of where the American people are in terms of their values and their priorities. And I believe, and I hope we share this view, that as we approach the budget, our number one priority has to be expanding economic growth, making sure we promote job creation, making sure we strengthen the middle class so that we don't have an economy that just works for some folks at the very top, but we have an economy that works for everybody in terms of rising wages and rising incomes, and a plan that meets the commitments we have made to people throughout the country, including our seniors.

That is the overriding goal. And reducing deficits, especially over the long term, has to be important part of that but it has to be seen in the context of the overriding goal: Job creation, strengthening the middle class. And so I hope as we have these discussions over how we reduce our deficits, what is the timing, and pace, and target of doing that, we look at it through the lens of job creation, strengthening of the middle class. And that should hold true whether we are talking about the short term, the medium term, or the long term.

Over the long term, there is no doubt, we see rising deficits, and the challenges we have said before is not whether we reduce those deficits, but again, the magnitude of the reduction, the timing of the reduction, and how we do it. And as the President said last night, we support taking a balanced approach to that, meaning cuts, and I would just remind my colleagues that over the last 2 years, including the Budget Control Act and previous actions, we will reduce spending by $1.5 trillion by capping discretionary spending.

As a result of the agreement to avoid the fiscal cliff, we will raise $600 billion in revenue from higher income earners. If you add up the interest savings on that, that is $2.5 trillion in deficit reduction.

Yes, we have to do more in outyears, but we believe in order to do it the right way and meet our commitments to our citizens and preserve economic growth and strength in the middle class, we have got to make sure we deal with that in a balanced way.

Now, let me just say in the short term, that means dealing with the sequester, Mr. Chairman. You cited the fact that CBO projects

1.4 percent growth. None of us want to see growth that slow. A full .6 percent of that growth is attributed—of that lack of growth, is attributed to the sequester. In other words, if we were to replace the sequester in a balanced way, you would add .6 percent to growth. And translating that number into actual jobs, and we will get testimony from Dr. Elmendorf, but we are talking about hundreds of thousands of jobs lost this year if we don't replace the sequester.

Now, we, on the Democratic side have in this Congress proposed a plan to replace the sequester. That $85 billion in meat-ax cuts, with a mix of cuts, which is in your budget as well, dealing with ag subsidies, getting rid of the direct payments, but also saying that we shouldn't be providing tax breaks to big oil companies, and that we believe we should apply the Buffett Rule to people making over $2 million a year.

We heard a lot of talk during the last election from both candidates and all candidates about all of the tax breaks in the Tax Code. Well, we should get rid of some of those, and we should get rid of some of those for the purpose of deficit reduction in a balanced way. And that is what our sequester replacement plan does in the short term, and frankly, that is what it would do in the long term. So we hope we can have an opportunity to have an up-or-down vote, Mr. Chairman, on the plan that we have put forward. We put it forward for a vote, at least two or three times now. We have going to be in the Rules Committee later today asking for a vote on that proposal that will save hundreds of thousands of jobs and prevent this disruption. And I hope we can have an opportunity, as you say, just to have a free flow of debate, and ultimately a vote and let the chips fall where they may. Thank you, Mr. Chairman.

[The prepared statement of Mr. Van Hollen follows:]

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

Thank you, Mr. Chairman. I want to join the Chairman in welcoming Dr. Elmendorf, and thank you and your team at the Congressional Budget Office for the professional work that you do.

Just at the outset, let me say, with respect to the timing of the President's budget submission, I think all of us who were part of the last Congress know that we struggled until January 2nd to pass legislation to avoid the fiscal cliff. The result of that legislation was to make sure that we did not see a sharp increase in taxes on middle income Americans, but we asked higher income individuals to begin to contribute to reducing the debt over the long term.

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And I believe, and I hope we share this view, that as we approach the budget, our number one priority has to be expanding economic growth; making sure we promote job creation; making sure we strengthen the middle class, so that we don't have an economy that just works for some folks at the very top, but we have an economy that works for everybody in terms of rising wages and rising incomes; and a plan that meets the commitments we've made to people throughout the country, including our seniors.

That's the overriding goal. And reducing deficits, especially over the long term, has to be an important part of that, but it has to be seen in the context of the overriding goal—job creation, strengthening the middle class. So I hope as we have these discussions over how we reduce our deficits, what's the timing and pace and target of doing that, we look at it through the lens of job creation, strengthening the middle class. And that should hold true whether we're talking about the short term, the medium term, or the long term.

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We heard a lot of talk during the last election from both candidates—and all candidates—about all the tax breaks in the tax code. Well, we should get rid of some of those, and we should get rid of some of those for the purpose of deficit reduction in a balanced way. And that's what our sequester replacement plan does in the short term, and frankly, that's what it would do in the long term.

So, we hope we can have an opportunity to have an up or down vote, Mr. Chairman, on the plan that we've put forward. We put it forward for a vote at least two or three times now—we're going to be in the Rules Committee later today asking for a vote on that proposal that will save hundreds of thousands of jobs and prevent this destruction. And I hope we can have an opportunity, as you say, just to have a free flow of debate and ultimately a vote, and let the chips fall where they may.

Thank you, Mr. Chairman.

Chairman RYAN. Thank you. I would love to begin the debate right now, but we have a hearing to get into. So, Dr. Elmendorf, the floor is yours.

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

Mr. ELMENDORF. Thank you, Mr. Chairman, Congressman Van Hollen, and to all members of the committee. I appreciate the opportunity to be here today, and to discuss with you CBO's outlook for the budget and the economy over the next 10 years. Our analysis shows that the country continues to face very large economic and budget challenges. Let me discuss the economy first and then I will turn to the budget.

We anticipate that economic growth will remain slow this year because the gradual improvement we see in underlying economic factors will be offset by a tightening of Federal fiscal policy scheduled under current law. The good news is that the effects of the financial and housing crisis appear to be gradually fading. We expect an upswing in housing construction, rising real estate and stock prices, and increasing availability of credit will help to spur a virtuous cycle of faster growth in employment, income, consumer spending, and business investment over the next few years.

However, several policies that will help to bring down the budget deficit will also represent a drag on economic activity this year. The expiration of the 2 percentage point cut in the Social Security payroll tax, the increase in tax rates on income above certain thresholds, and the cuts in Federal spending scheduled to take effect next month, will mean reduced spending by both households and the government. We project an inflation-adjusted GDP will increase by about 1.5 percent in 2013, but it would increase roughly 1.5 percentage points faster were it not for that fiscal tightening.

Under current law then, we expect the unemployment rate will stay above 7.5 percent through next year. That would make 2014 the sixth consecutive year with unemployment so high, the longest such period since the 1930s. We expect that growth in real GDP will pick up after this year to about 3.5 percent per year in 2014, and the following few years. But the gap between the Nation's GDP and what it is capable of producing on a sustained basis, the economists refer to as potential GDP, will still not close quickly. Under current law, we expect output to remain below its potential level until 2017, nearly a decade after the recession started in December 2007.

The Nation has paid and will continue to pay a big price for the recession and slow recovery. We estimate that the total loss in output relative to the economy's potential between 2007 and 2017 will be nearly equivalent to half of the total output produced in the country last year.

Let me turn then to the budget. Under current laws, the Federal budget deficit will shrink in 2013 for the fourth year in a row, and an estimated $845 billion, the deficit would be the first in 5 years below $1 trillion, and at 5.25 percent of GDP, only about half as large relative to the size of the economy as the deficit was in 2009. Our projections, based on current law, show deficits continuing to fall over the next few years before turning up again in the second half of the decade, and totaling nearly $7 trillion over the decade as a whole.

Federal revenues are projected to reach 19 percent of GDP in 2015 and beyond, because of both the expanding economy and schedule changes in tax rules. That 19 percent figure compares on average of about 18 percent over the past 40 years. At the same time, Federal spending will fall relative to the size of the economy over the next several years, and then rise again. The decline can be traced to the caps on discretionary funding and a drop-off in spending attempts to go up when the economy is weak, like unemployment benefits. But later in the decade, the return of interest rates to more normal levels will push up interest payments to nearly their highest share of GDP in 50 years. And throughout the decade, the aging of the population, a significant expansion of Federal health care programs, and rising health care costs per person, will push up spending on the largest Federal programs.

By 2023, spending reaches about 23 percent of GDP in our projection compared with the 40-year average of about 21 percent. What does this mean for Federal debt? We project the debt held by the public will reach 76 percent of GDP this year, the largest percentage since 1950. And under current laws, we project the debt in 2023 will be 77 percent of GDP, far higher than the 39 percent average of the past 40 years, and it will be on an upward path. Such high and rising debt relative to the size of the economy is a significant concern for several reasons: First, high debt means that the crowding out of capital investment will be greater, that you will have less flexibility to use tax and spending policies to respond to unexpected challenges like a recession, or a war, and that there will be a heightened risk of a fiscal crisis in which the government would be unable to borrow at affordable interest rates.

Second, debt would be even larger if current laws were modified to delay or undo scheduled changes in policies. For example, if lawmakers eliminated the automatic spending cuts scheduled to take in effect in March, but left in place the original caps from the Budget Control Act, if they prevented the sharp reduction in Medicare's payment rates for physicians scheduled to occur next January, and extended the tax provisions that are scheduled to expire, and if no offsetting changes were made, then budget deficits would be substantially larger than our baseline projections, and debt held by the public would rise to 87 percent of GDP by 2023, rather than 77 percent under current law.

Third, debt might also be larger than in our projections, because even the original caps on discretionary funding in the Budget Control Act would reduce such spending to just 5.8 percent of GDP in 2023, a smaller share than for any year in at least the past 50. Because the allocation of discretionary funding is determined, as you know, through annual appropriation acts, you and your colleagues have not yet decided which specific government services and benefits will be constrained or cut to meet those caps, and doing so might be quite difficult.

Fourth, projections for the 10-year period covered in this report do not fully reflect long-term budget pressures. Because of the retirement of the baby-boom generation and rising health care costs, a wide gap exists between the future costs of the benefits and services that people are accustom to receiving from the Federal Government, especially in the form of benefits for older Americans, and the tax revenue that people have been sending to the government.

It is possible to keep tax revenues at their historical average percentage of GDP, but only by making substantial cuts relative to current policies in the large benefit programs that aid a broad group of people at some point in their lives. Alternatively, it is possible to keep the policies for those large benefit programs unchanged, but only by raising taxes substantially for a broad segment of the population. Deciding now what combination of policy changes to make to resolve the budget imbalance would allow for gradual implementation of those changes which would give households and businesses time to adjust their behavior. Thank you.

Chairman RYAN. Thank you, Dr. Elmendorf.

[The prepared statement of Douglas Elmendorf follows:]

Congressional Budget Office

Testimony

The Budget and Economic Outlook: Fiscal Years 2013 to 2023

Douglas W. Elmendorf
Director

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

February 13, 2013

This document is embargoed until it is delivered at 10:00 a.m. (EST) on Wednesday, February 13, 2013. The contents may not be published, transmitted, or otherwise communicated by any print, broadcast, or electronic media before that time.

CONGRESS OF THE UNITED STATES

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 2013 to 2023. Those estimates were released last week in the report titled *The Budget and Economic Outlook: Fiscal Years 2013 to 2023.*

Economic growth will remain slow this year, CBO anticipates, as gradual improvement in many of the forces that drive the economy is offset by the effects of budgetary changes that are scheduled to occur under current law. After this year, economic growth will speed up, CBO projects, causing the unemployment rate to decline and inflation and interest rates to eventually rise from their current low levels. Nevertheless, the unemployment rate is expected to remain above 7½ percent through next year; if that happens, 2014 will be the sixth consecutive year with unemployment exceeding 7½ percent of the labor force—the longest such period in the past 70 years.

If the current laws that govern federal taxes and spending do not change, the budget deficit will shrink this year to $845 billion, or 5.3 percent of gross domestic product (GDP), its smallest size since 2008. In CBO's baseline projections, deficits continue to shrink over the next few years, falling to 2.4 percent of GDP by 2015. Deficits are projected to increase later in the coming decade, however, because of the pressures of an aging population, rising health care costs, an expansion of federal subsidies for health insurance, and growing interest payments on federal debt. As a result, federal debt held by the public is projected to remain historically high relative to the size of the economy for the next decade. By 2023, if current laws remain in place, debt will equal 77 percent of GDP and be on an upward path, CBO projects (see Figure 1).

Such high and rising debt would have serious negative consequences: When interest rates rose to more normal levels, federal spending on interest payments would increase substantially. Moreover, because federal borrowing reduces national saving, the capital stock would be smaller and total wages would be lower than they would be if the debt was reduced. In addition, lawmakers would have less flexibility than they might ordinarily to use tax and spending policies to respond to unexpected challenges. Finally, such a large debt would increase the risk of a fiscal crisis, during which investors would lose so much confidence in the government's ability to manage its budget that the government would be unable to borrow at affordable rates.

Under Current Law, Federal Debt Will Stay at Historically High Levels Relative to GDP

The federal budget deficit, which shrank as a percentage of GDP for the third year in a row in 2012, will fall again in 2013, if current laws remain the same. At an estimated $845 billion, the 2013 imbalance would be the first deficit in five years below $1 trillion; and at 5.3 percent of GDP, it would be only about half as large, relative to the size of the economy, as the deficit was in 2009. Nevertheless, if the laws that govern taxes and spending do not change, federal debt held by the public will reach 76 percent of GDP by the end of this fiscal year, the largest percentage since 1950.

With revenues expected to rise more rapidly than spending in the next few years under current law, the deficit is projected to dip as low as 2.4 percent of GDP by 2015 (see Table 1). In later years, however, projected deficits rise steadily, reaching almost 4 percent of GDP in 2023. For the 2014–2023 period, deficits in CBO's baseline projections total $7.0 trillion. With such deficits, federal debt would remain above 73 percent of GDP—far higher than the 39 percent average seen over the past four decades. (As recently as the end of 2007, federal debt equaled just 36 percent of GDP.) Moreover, debt would be increasing relative to the size of the economy in the second half of the decade.

Those projections are not CBO's predictions of future outcomes. As specified in law, CBO's baseline projections are constructed under the assumption that current laws generally remain unchanged, so that they can serve as a benchmark against which potential changes in law can be measured.

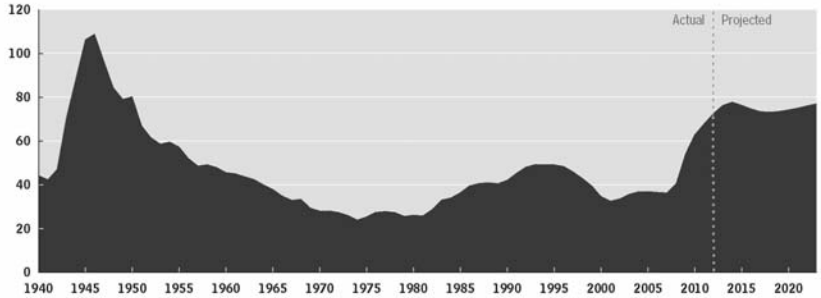
Revenues

Federal revenues will increase by roughly 25 percent between 2013 and 2015 under current law, CBO projects. That increase is expected to result from a rise in income because of the growing economy, from policy changes that are scheduled to take effect during that

Figure 1.

Federal Debt Held by the Public

(Percentage of gross domestic product)



Source: Congressional Budget Office.

period, and from policy changes that have already taken effect but whose full impact on revenues will not be felt until after this year (such as the recent increase in tax rates on income above certain thresholds).

As a result of those factors, revenues are projected to grow from 15.8 percent of GDP in 2012 to 19.1 percent of GDP in 2015—compared with an average of 17.9 percent of GDP over the past 40 years. Under current law, revenues will remain at roughly 19 percent of GDP from 2015 through 2023, CBO estimates.

Outlays

In CBO's baseline projections, federal spending rises over the next few years in dollar terms but falls relative to the size of the economy. During those years, the growth of spending will be restrained both by the strengthening economy (as spending for programs such as unemployment compensation drops) and by provisions of the Budget Control Act of 2011 (Public Law 112-25). Although outlays are projected to decline from 22.8 percent of GDP in 2012 to 21.5 percent by 2017, they will still exceed their 40-year average of 21.0 percent. (Outlays peaked at 25.2 percent of GDP in 2009 but have fallen relative to GDP in the past few years.)

After 2017, if current laws remain in place, outlays will start growing again as a percentage of GDP. The aging of the population, increasing health care costs, and a significant expansion of eligibility for federal subsidies for health insurance will substantially boost spending for Social Security and for major health care programs relative to the size of the economy. At the same time, rising interest rates will significantly increase the government's debt-service costs. In CBO's baseline, outlays reach about 23 percent of GDP in 2023 and are on an upward trajectory.

Changes from CBO's Previous Projections

The deficits projected in CBO's current baseline are significantly larger than the ones in CBO's baseline of August 2012. At that time, CBO projected deficits totaling \$2.3 trillion for the 2013–2022 period; in the current baseline, the total deficit for that period has risen by \$4.6 trillion. That increase stems chiefly from the enactment of the American Taxpayer Relief Act of 2012 (P.L. 112-240), which made changes to tax and spending laws that will boost deficits by a total of \$4.0 trillion (excluding debt-service costs) between 2013 and 2022, according to estimates by CBO and the staff of the Joint Committee on Taxation. CBO's updated baseline also takes into account other legislative actions since August, as well as a new economic forecast and some technical revisions to its projections.

Table 1.

CBO's Baseline Budget Projections

	Actual, 2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total 2014-2018	Total 2014-2023
							In Billions of Dollars							
Revenues	2,449	2,708	3,003	3,373	3,591	3,765	3,937	4,101	4,279	4,496	4,734	4,961	17,669	40,241
Outlays	3,538	3,553	3,618	3,803	4,067	4,300	4,542	4,811	5,078	5,350	5,691	5,939	20,330	47,199
Deficit (-) or Surplus	**-1,089**	**-845**	**-616**	**-430**	**-476**	**-535**	**-605**	**-710**	**-798**	**-854**	**-957**	**-978**	**-2,661**	**-6,958**
On-budget	-1,151	-872	-630	-433	-476	-533	-598	-693	-763	-799	-878	-872	-2,670	-6,675
Off-budget[a]	62	27	14	3	*	-2	-6	-17	-35	-55	-79	-106	9	-283
Debt Held by the Public at the End of the Year	11,280	12,229	12,937	13,462	14,025	14,642	15,316	16,092	16,957	17,876	18,902	19,944	n.a.	n.a.
							As a Percentage of Gross Domestic Product							
Revenues	15.8	16.9	18.0	19.1	19.1	18.9	18.8	18.7	18.7	18.9	19.0	19.1	18.8	18.9
Outlays	22.8	22.2	21.7	21.6	21.6	21.5	21.7	22.0	22.2	22.4	22.9	22.9	21.6	22.1
Deficit	**-7.0**	**-5.3**	**-3.7**	**-2.4**	**-2.5**	**-2.7**	**-2.9**	**-3.2**	**-3.5**	**-3.6**	**-3.8**	**-3.8**	**-2.8**	**-3.3**
Debt Held by the Public at the End of the Year	72.5	76.3	77.7	76.3	74.6	73.4	73.1	73.5	74.2	75.0	76.0	77.0	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.

Looming Policy Decisions May Have a Substantial Effect on the Budget Outlook

Current law leaves many key budget issues unresolved, and this year, lawmakers will face three significant budgetary deadlines:

- Automatic reductions in spending are scheduled to be implemented at the beginning of March; when that happens, funding for many government activities will be reduced by 5 percent or more.

- The continuing resolution that currently provides operational funding for much of the government will expire in late March. If no additional appropriations are provided by then, nonessential functions of the government will have to cease operations.

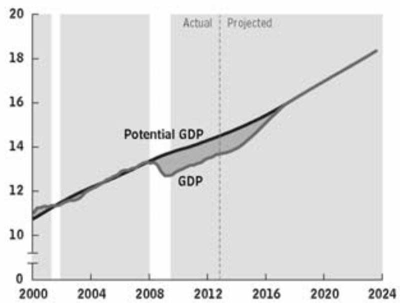
- A statutory limit on federal debt, which was temporarily removed, will take effect again in mid-May. The Treasury will be able to continue borrowing for a short time after that by using what are known as extraordinary measures. But to avoid a default on the government's obligations, the debt limit will need to be adjusted before those measures are exhausted later in the year.

Budgetary outcomes will also be affected by decisions about whether to continue certain policies that have been in effect in recent years. Such policies could be continued, for example, by extending some tax provisions that are scheduled to expire (and that have routinely been extended in the past) or by preventing the 25 percent cut in Medicare's payment rates for physicians that is due to occur in 2014. If, for instance, lawmakers eliminated the automatic spending cuts scheduled to take effect in March (but left in place the original caps on discretionary funding set by the Budget Control Act), prevented the sharp reduction in Medicare's payment rates for physicians, and extended the tax provisions that are scheduled to expire at the end of calendar year 2013 (or, in some

Figure 2.

GDP and Potential GDP

(Trillions of 2005 dollars)



Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

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

Data are quarterly. Actual data are plotted through the third quarter of 2012. Projections are plotted through the fourth quarter of 2023.

cases, in later years), budget deficits would be substantially larger over the coming decade than in CBO's baseline projections. With those changes, and no offsetting reductions in deficits, debt held by the public would rise to 87 percent of GDP by the end of 2023 rather than to 77 percent.

In addition to those decisions, lawmakers will continue to face the longer-term budgetary issues posed by the substantial federal debt and by the implications of rising health care costs and the aging of the population.

Economic Growth Is Likely to Be Slow in 2013 and Pick Up in Later Years

The U.S. economy expanded modestly in calendar year 2012, continuing the slow recovery seen since the recession ended in mid-2009. Although economic growth is expected to remain slow again this year, CBO anticipates that underlying factors in the economy will spur a more rapid expansion beginning next year.

Even so, under the fiscal policies embodied in current law, output is expected to remain below its potential (or maximum sustainable) level until 2017. By CBO's estimates, in the fourth quarter of 2012, real (inflation-adjusted) GDP was about 5½ percent below its potential level. That gap was only modestly smaller than the gap between actual and potential GDP that existed at the end of the recession (see Figure 2) because the growth of output since then has been only slightly greater than the growth of potential output. With such a large gap between actual and potential GDP persisting for so long, CBO projects that the total loss of output, relative to the economy's potential, between 2007 and 2017 will be equivalent to nearly half of the output that the United States produced last year.

The Economic Outlook for 2013

CBO expects that economic activity will expand slowly this year, with real GDP growing by just 1.4 percent (see Table 2). That slow growth reflects a combination of ongoing improvement in underlying economic factors and fiscal tightening that has already begun or is scheduled to occur—including the expiration of a 2 percentage-point cut in the Social Security payroll tax, an increase in tax rates on income above certain thresholds, and scheduled automatic reductions in federal spending. That subdued economic growth will limit businesses' need to hire additional workers, thereby causing the unemployment rate to stay near 8 percent this year, CBO projects. The rate of inflation and interest rates are projected to remain low.

The Economic Outlook for 2014 to 2018

After the economy adjusts this year to the fiscal tightening inherent in current law, underlying economic factors will lead to more rapid growth, CBO projects—3.4 percent in 2014 and an average of 3.6 percent a year from 2015 through 2018. In particular, CBO expects that the effects of the housing and financial crisis will continue to fade and that an upswing in housing construction (though from a very low level), rising real estate and stock prices, and increasing availability of credit will help to spur a virtuous cycle of faster growth in employment, income, consumer spending, and business investment over the next few years.

Nevertheless, under current law, CBO expects the unemployment rate to remain high—above 7½ percent through 2014—before falling to 5½ percent at the end of 2017. The rate of inflation is projected to rise slowly after

Table 2.

CBO's Economic Projections for Calendar Years 2012 to 2023

	Estimated, 2012	Forecast 2013	Forecast 2014	Projected Annual Average 2015–2018	Projected Annual Average 2019–2023
		Fourth Quarter to Fourth Quarter (Percentage change)			
Real Gross Domestic Product	1.9	1.4	3.4	3.6	2.2
Inflation					
PCE price index	1.5	1.3	1.8	1.9	2.0
Core PCE price index[a]	1.5	1.5	1.9	2.0	2.0
Consumer price index[b]	1.9 [c]	1.5	2.0	2.2	2.3
Core consumer price index[a]	1.9 [c]	1.8	2.0	2.2	2.3
		Fourth Quarter Level (Percent)			
Unemployment Rate	7.8 [c]	8.0	7.6	5.5 [d]	5.2 [e]
		Calendar Year Average (Percent)			
Interest Rates					
Three-month Treasury bills	0.1 [c]	0.1	0.2	2.2	4.0
Ten-year Treasury notes	1.8 [c]	2.1	2.7	4.5	5.2

Source: Congressional Budget Office. (Actual values for 2012 are from Department of Labor, Bureau of Labor Statistics; Federal Reserve.)

Notes: The numbers shown here do not reflect the values for GDP and related series released by the Commerce Department's Bureau of Economic Analysis on January 30.

PCE = personal consumption expenditures.

a. Excludes prices for food and energy.

b. The consumer price index for all urban consumers.

c. Actual value for 2012.

d. Value for 2018.

e. Value for 2023.

this year: CBO estimates that the annual increase in the price index for personal consumption expenditures will reach about 2 percent in 2015. The interest rate on 3-month Treasury bills—which has hovered near zero for the past several years—is expected to climb to 4 percent by the end of 2017, and the rate on 10-year Treasury notes is projected to rise from 2.1 percent in 2013 to 5.2 percent in 2017.

The Economic Outlook for 2019 to 2023

For the second half of the coming decade, CBO does not attempt to predict the cyclical ups and downs of the economy; rather, CBO assumes that GDP will stay at its maximum sustainable level. On that basis, CBO projects that both actual and potential real GDP will grow at an average rate of 2¼ percent a year between 2019 and 2023. That pace is much slower than the average growth rate of potential GDP since 1950. The main reason is that the growth of the labor force will slow down because of the retirement of the baby boomers and an end to the long-standing increase in women's participation in the labor force. CBO also projects that the unemployment rate will fall to 5.2 percent by 2023 and that inflation and interest rates will stay at about their 2018 levels throughout the 2019–2023 period.

Chairman RYAN. Let me get into the debt itself. We had the State of the Union address last night, and you know, as we all do, we go to the microphones and give our play-by-play analysis of what we thought of the speech and what we liked and what we didn't like. One thing stood out that gave me a real cause for concern. I heard it just with Mr. Van Hollen's opening statement, which gives me very big cause for concern, which it seems as if they think the heavy lifting on debt reduction, deficit reduction is behind us, as we have just got a little bit left and then we are done. The notion that we have already got $2.5 trillion of deficit reduction taking care of, it is in the bank, we are not much farther to go to finish the job. This calculation, this $2.5 trillion of debt reduction does not count the spending that took place during that time. It doesn't count the stimulus spending, $831 billion. It doesn't account for the first payroll tax holiday, $111 billion. It doesn't account for the second payroll tax holiday $89 billion. It doesn't account for the multiple unemployment extensions. It doesn't account for the 24 percent increase in non-defense discretionary spending that occurred in the first 2 years of the administration. It doesn't account for the disaster spending that has taken place annually, or the Sandy supplemental. It doesn't account for the debt servicing of all of that additional spending.

You wash it out, you net it out, it is about $500 billion roughly of deficit reduction; not $2.5 trillion. But when you hear such projections which ignore the spending that occurred at the same time, I really worry that part of our government here, two-thirds of it, you know, the Senate and the White House, and our friends over on the other side of the aisle, are deluding themselves into thinking this is taken care of.

Look, you say in your own report here, publicly held debt has doubled from 36 percent of GDP at the close of 2007, to 73 percent on 2012, on page 3, 77 percent by 2023. I guess this is your new alternate fiscal scenario meaning doc fix, all of the other things you think Congress will do based on, you know, reasonable assumptions. We could go as high as 87 percent of GDP of publicly-held debt. Total debt is already above 100 percent of GDP. If you could bring up chart one.

Here is the question I have. The green is what you said revenues are historically, about 18.3 percent. The blue line are all of the tax increases the President has supported, endorsed, the loophole closers Mr. Van Hollen talks about, much of this has already been enacted, but the fiscal cliff deal enacted a good portion of the blue, the revenues the President is calling for. The red are your projections on where spending is going.

So even if we got every tax increase that the President has called for, we are not even scratching the surface. We are not even getting close to fixing this problem. And so the concern I have is a couple of things: What happens if we don't get this under control? What does a debt crisis look like? What happens to families? What happens to a Nation if our debt continues on this burden, if we go to where your alternative fiscal scenario goes, or where your baseline projection goes, if we don't actually turn this around, what happens? That is question number one.

Question number two is, and I am going to ask you this in writing, give me some different interest rates scenarios. What happens if interest rates rise faster than you are projecting? What happens to our ability to control our fiscal situation? What happens to our economy?

Mr. ELMENDORF. So Mr. Chairman, let me just quickly clarify two points on what you said so we can understand. We have not yet updated our long-term budget projection. I presume this slide is our new projections for the coming decade and your extrapolation beyond that, but it certainly is the case in our long-term outlook last year, and I presume will be true in our long-term outlook this year, that spending, particularly on the large health care programs and on Social Security, will continue to rise as a share of the economy over time driven most importantly by the aging of our population, and the rising number of eligible beneficiaries, and also due to other factors as well.

The second point to clarify is that alternative fiscal scenario is not meant to be a projection of what actually you and your colleagues will do. As you know, it is a projection of what current policies would cost; in fact, we all presume that you will make some changes in policies over the decade, but it is an additional benchmark that many of you have found helpful in the past in addition to our standard presentation of what would happen under current law.

Chairman RYAN. Because you have a new AFS baseline, what is the basic assumption, because we had some new things that happen that deal with the fiscal cliff.

Mr. ELMENDORF. So people understand, our basic projections follow current law. That assumes, for example, now, that the tax provision scheduled to expire at the end of this year, many of which are routinely extended, our current law projection assumes they will expire. In our alternative scenario, we extend all of those expiring tax provisions. Current law includes a cut in Medicare's payments to doctors at the end of this year. Congress has routinely pushed off that cut and made other changes in health care policy along the way.

Our alternative scenario, continues, extrapolates the current payment rates to physicians. And current law includes the sequester, and many Members of Congress have argued that they would like to do something different instead of that. So our alternative scenario takes away the sequester, but leaves in place the original caps that Congress agreed to in August of 2011. So under the alternative scenario, our total debt rises by about $2.5 trillion more over the coming decade than under the current law baseline projections.

Mr. Chairman, you asked what happens if debt rises, stays high and rises, and there are some costs that I think are quite predictable, and other risks that are created. Over time, not under the current economic conditions, but under the conditions that we expect for later in the decade of nearly full employment in the economy, at that point in time, that large amount of debt will crowd out some private investment that would then raise wages and incomes. And the more of that, the higher the debt is, the more of that investment is likely to be crowded out, and the greater the depressing effect on wages and incomes.

Economists have models to capture that and we report those sorts of estimates to you. But there are also risks that are involved. Some countries that have had very high levels of debt, and have not communicated or not persuaded their potential lenders that they have a plan for getting that under control, have faced a fiscal crisis, which we defined as a point at which the government is unable to borrow at affordable rates.

Currently, our government is not at all in that position. Currently interest rates, Treasury interest rates are extraordinarily low. Our projection calls for a normalization of interest rates as the economy strengthens, as the Federal Reserve stops pushing so hard to keep interest rates low. We have a normalization of interest rates in our basic projections, but with debt high and rising, there is a greater risk that potential buyers of government debt will get spooked and will be unwilling to do so at the regular level of interest rates.

If interest rates were a percentage point higher than we project over the entire decade, then the Federal Government's interest costs would be about $1.1 trillion higher. If interest rates were a percentage point lower than we project, then the Federal Government's interest payments would be about $1.1 trillion lower. The point is, that given the large amount of debt the Federal Government has and will have under current law for the coming decade, fairly small movements in interest rates can have fairly large effects on government interest payments.

Chairman RYAN. What is your normalized rate assumption? I don't recall off the top of my head.

Mr. ELMENDORF. So we are projecting that short-term interest rates rise to about 4 percent and that longer-term, 10-year Treasury note rates rise to 5.25 percent. Those rates, after adjusting for inflation, are a little above inflation-adjusted interest rates over the past several decades, reflecting, in our view, the effects of a higher level of debt relative to what we have experienced in past decades.

Chairman RYAN. So for the comity of the committee, Mr. Van Hollen and I are limiting ourselves to 10 minutes. We don't always do that. We have a lot of people here, so I will be brief only to say that it seems we have this window that is beginning to narrow on us. As you mentioned, America is right now, with respect to the bond markets, the port in the storm, the safe haven. We are the world's reserve currency. That gives us a privilege. That gives us time. But if we fritter this time away, if we don't deal with the core problem, which is spending no matter what you try to do on revenues, then we will have lost this opportunity we have to get our fiscal house in order while we have low interest rates.

The other problem, as we see it, is growth. If we keep chasing higher spending with higher taxes, we will sacrifice growth. The best way is to get people back to work, in good jobs, with good wages, paying taxes, and getting spending under control. And so when we talk about taxes and tax reform, this is something for the Ways and Means Committee, or something we will discuss here, loopholes are part of tax reform. Closing loopholes, which is what we proposed for years, is a necessary pay-for to get tax rates down, to have a globally competitive Tax Code, to help businesses, to create jobs, to get people back to work. And if we used loopholes to chase higher spending, then we are foregoing tax reform and missing our opportunity for economic growth. That I just want to make very clear for the record because I think we will hear a lot of political rhetoric to the contrary, and with that, I want to yield to Mr. Van Hollen for his 10 minutes.

Mr. VAN HOLLEN. Thank you, Mr. Chairman, and again, welcome, Dr. Elmendorf. First, just a little bit on the math. The chairman pointed out that while we will have $1.5 trillion in cuts over the next 10 years as a result of the spending caps. There were some other one-time spending measures. Included in those spending measures, actually, the payroll tax cut, which was probably the biggest single item in that issue, and there was actually agreement that given tough economic times, it was important to provide a payroll tax relief. I actually think we should have phased that out rather than having gone cold turkey, but the point is, a big chunk of that number had to do with lost revenue from a payroll tax cut that was supported by a great majority in this body.

As I said in my opening remarks, I think that our overall objective here in the short, medium, and long term needs to be expanding the economy, growing jobs, and having a strong middle class. So it is absolutely true that especially as the economy recovers, if you continue to have high deficits, it will squeeze out that private investment and put upward pressure on interest rates. So in order to make sure we have good long-term economic growth, we have to grapple with the deficit, that just brings us back to the question of how we deal with the deficit, and as Dr. Elmendorf pointed out, you can have sort of two categorical ways. One, you could say, well, we are not going to do any revenue. We are going to do it all in cuts, and as you pointed out, you can do it all on, you know, revenue and no cuts.

Both of those lead and argue to bad results. You can't raise revenue enough realistically to cover all of those costs, but cutting, as Dr. Elmendorf said, means undermining important commitments that we have made when it comes to retirement, health, and security for our seniors.

So again, the question is how we deal with those deficits. Now, let me get back to the sequester issue because that is looming right now. Could you tell me, Dr. Elmendorf, in terms of the negative economic impact of the sequester, the .6 percent, what does that translate into in terms of lost jobs?

Mr. ELMENDORF. So our estimate is, as the Congressman says, that the sequester alone will reduce GDP growth this year by 0.6 percentage points, lowering the level of GDP at the end of the year by that 0.6 percent. We think that would reduce the level of employment at the end of the year by about 750,000 jobs.

Mr. VAN HOLLEN. Seven hundred and fifty thousand jobs between now at the end of this fiscal calendar year 2013, right?

Mr. ELMENDORF. Yes, Congressman.

Mr. VAN HOLLEN. That is a whole lot of jobs, obviously, and we should be working overtime to prevent that kind of job loss. Now, if you were to replace the deficit reduction through that austerity program, the meat-ax cuts to the sequester, with a plan that accomplished the same amount of deficit reduction, spread over the 10-year period, you would not have that big hit on jobs, isn't that right?

Mr. ELMENDORF. That is right, Congressman.

Mr. VAN HOLLEN. Now, we have also heard a lot about the impact as a result of the defense cuts, and I should point out, this is not—it is the Congressional Budget Office's analysis, our analysis. The Republican leader, Mr. Cantor, had it exactly right last September on the floor of the House when he said that if we allowed that sequester to take place, "unemployment would soar." It would set back progress on the economy. And he cited an estimate that the sequester would cost 200,000 jobs in the State of Virginia alone. That was if the sequester for the full year went over. We were able to prevent the sequester for the first 2 months through a balanced approach, I should say, a combination of cuts and revenue. That should be the model going forward and that is the model that we have applied to prevent the sequester.

Now, just to be clear, since there has been a lot of attention focused on the jobs lost because of defense cuts, the cuts in the non-defense as a result of the sequester, on a dollar-for-dollar basis, does that result in the same amount of jobs lost?

Mr. ELMENDORF. The effects of cuts in defense spending and non-defense spending will be quite similar dollar for dollar. The precise timing of the economic effects depends on a timing in which defense spending and non-defense spending occurs. So in some circumstances, there could be small differences. But basically, Congressman, you are right. If the government is paying people to build battle ships, or paying people to build other sorts of equipment, or structures, then those will have comparable effects, dollar for dollar, on the economy, on output, and on jobs.

Mr. VAN HOLLEN. Right. I have never understood the logic as to how cuts to defense, meaning you are not building as many tanks or battleships somehow costs jobs, but cuts to other government spending somehow do not cost jobs. Obviously, when you investment money to build roads and bridges and other transportation systems, you are putting people to work doing things that are productive for our economy.

If it is scientists at NIH or other people around the country, those are grants that are being spent to try and find treatments and cures for lifesaving diseases. It would be absolutely counterproductive in terms of the long-term competitiveness, let alone the health of our people, to have those kind of cuts take place. And on top of that, there is long-term negative impacts. You have got the job loss, 750,000 jobs between now and the end of the month.

Let me just say something, Dr. Elmendorf, about the tax reform. I don't know if you have done a recent estimate of the amount of tax expenditures in the tax code. What is your most recent estimate, and——

Mr. ELMENDORF. So we, in last year's outlook which was a longer document since we had a little more time, we had an extended discussion of tax expenditures. We have not updated that this year, but the staff of the Joint Committee on Taxation has released a new estimate, I believe, of tax expenditures, or certainly they are working on one. And tax expenditures amount to a very large amount of money, and I think many economists agree that they are really best viewed as a form of government spending because they are directed at particular people, or entities, or designed to subsidize particular activities, are very much analogous to the way that government spending is often directed at particular people, remedies, or designed to subsidize particular activities.

So it is essentially a large component of spending by the Federal Government, even though it is recorded essentially as lost revenue on the revenue side of the budget.

Mr. VAN HOLLEN. That is right. I mean, it is spending through the Tax Code by saying to certain interest, sometimes based on policies we agree, there is consensus on, sometimes not, that that is revenue that will not come into the Treasury to help reduce the deficit. And the chairman pointed out that we just, you know, we passed the $600 billion tax increase focused on folks at the very high end of the income scale, but as the President pointed out in the talks with the Speaker, his goal was actually to achieve $1.2 trillion revenue, which I would point out to our colleagues is less revenue imbedded in that plan than in the bipartisan Simpson-Bowles plan which said that we should do tax reform, but in addition to reducing the rates, we should have a significant amount go to deficit reduction.

In fact, the bipartisan Simpson-Bowles Commission Report would have a lot more revenue coming in than the President has proposed. I just want to make that clear to our colleagues. I would also point out that Speaker Boehner, during those discussions with the President, said he didn't want to increase rates, but he could raise $800 billion by closing these tax loopholes and breaks and getting rid of these tax expenditures.

Those are all still there. None of the actions we have taken eliminate those tax breaks and tax expenditures that the Speaker was talking about, that all of the candidates in the past presidential election talked about, and so if we agree, Mr. Chairman, that those are just different forms of spending in the Tax Code, it seems to me we should be willing to help eliminate some of those tax expenditures for the purpose of reducing the deficit in a balanced way.

And just to be clear, what our colleagues to date have said is, they are not willing to do that. They are not willing to eliminate any of those tax expenditures, spending in the Tax Code for the purpose of reducing the deficit. And we think that is important as part of a balanced plan, combined with targeted cuts, reforms, going forward.

A last point I would say, is if you look at the chairman's chart, there is no doubt, there is no doubt, we have to deal with this issue. But as you know, you can pass changes to laws in this 10-year window that have a very important impact in the outyears, which is, of course, what your budget did last time. Arbitrarily, trying to squeeze all of that into the 10-year window, which apparently was what the Speaker had agreed to do as part of extending the 3-month debt ceiling, is not good economics. That is politics, and so I would hope that as we go through this process, we keep an eye on the point I raised at the beginning. What is the impact on the economy, short term, middle term, long term? What is the impact on middle class and jobs? Thank you, Mr. Chairman.

Chairman RYAN. You bet. I would say balancing the budget is good economics, but I guess we just disagree on that. Dr. Price.

Mr. PRICE. Thank you, Mr. Chairman. Let me follow up quickly on that. Mr. Director, welcome back to the committee. We appreciate your insight, your input. Is it better to have a balanced budget than not?

Mr. ELMENDORF. Well, Congressman, I think that depends on what your values are. The reason that CBO doesn't make recommendations about budget policy, is because the course that you and your colleagues choose depends not just on the sort of analysis we can provide, but on your judgments.

Mr. PRICE. The level of debt that you described, 76 percent of public debt held right now, 87 percent going under, I guess, your alternative fiscal scenario, I suspect you would agree that a level of 87 percent is not as wise as a level of 76 percent given the propensity for a fiscal crisis at 87 being higher than 76, is that right?

Mr. ELMENDORF. Yes, we certainly agree that the higher debt has higher expected costs and higher risks than lower debt would have.

Mr. PRICE. And I would concur. I want to touch briefly on the fiscal cliff, the $600 billion increase in taxes. Would that—do you recall what the spending reductions were in that legislation, the net spending reductions?

Mr. ELMENDORF. Well, so Congressman, remember that the way—the cost estimate that we produced and that we produced for all bills, is relative to current law.

Mr. PRICE. Yes.

Mr. ELMENDORF. So our cost estimate showed that legislation as a very large tax cut, not the tax increase that you just described.

Mr. PRICE. Yes.

Mr. ELMENDORF. There were only small changes in spending. I don't remember how they netted out. There was an extra, additional spending in Medicare, but cutbacks in other health care spending. The sequester was deferred. That was paid for partly, as you know, through other spending reduction.

Mr. PRICE. Minimal spending reductions in the fiscal cliff bill. So that this balanced approach that our friends on the other side of the aisle talk about is balanced until it isn't. And that is what we saw with the fiscal cliff.

I want to touch on the whole issue of revenue. Your report cites that revenue has returned essentially in 2012 to the 2008 levels, or higher than the 10-year average, basically. Is that accurate?

Mr. ELMENDORF. That may well be right. I am sorry, I don't have all of that history in front of me, Congressman.

Mr. PRICE. I think that is correct. The revenue of the Federal Government now has returned to higher than the 10-year average.

That being the case, and if we look at the deficit in 2008 at about $450 billion, and the deficit in 2012 at $1.3 trillion, with revenue returning essentially to 2008 level, then isn't it true that the thing that is driving the deficit to a greater degree at this point is not that the revenues are lower than they have been, but the spending is higher than it has been. Is that an accurate statement?

Mr. ELMENDORF. Well, certainly in dollar terms, Congressman, you are right that spending is going up very sharply. I think the problem that you and your colleagues face is that from the perspective of many Americans who are now starting to retire in the Baby-Boom Generation, there are benefits that they are expecting individually. The fact that there are many more of them than there were beneficiaries 10 and 20 years ago, doesn't appear to them as an excess of the benefits they are getting, but it turns out, you take a given benefit and multiply it by a lot more people——

Mr. PRICE. Yes.

Mr. ELMENDORF [continuing]. That the aggregate spending goes up, and that is, I think, the challenge you and your colleagues face is how to respond to that.

Mr. PRICE. Yes, it is indeed, and we look forward to working through a budgetary process that will save and strengthen and secure those programs as opposed to moving in the direction of essentially lopping off funding for those programs at the expense of those beneficiaries. That is a debate that we will have.

I want to touch again back on the 76 percent, 87 percent. Your alternative fiscal scenario has really been more, in the past has really been more accurate compared to reality, is that a true statement?

Mr. ELMENDORF. I suppose that is true. I mean, the single biggest difference, as you know, between that and the baseline, had been the extension of the expiring tax provisions and in fact, the Congress chose about a month ago to extend most of those expiring tax provisions. In that sense, our current baseline looks more like our last alternative scenario, than like our last baseline.

Mr. PRICE. Right. So if past is prologue, then it is more likely that we will be closer to 87 percent public debt held as opposed to 76 percent? And if that is——

Mr. ELMENDORF. I think if you and your colleagues let current policy stand, that would be the case. Whether you will or not is the issue that you are debating.

Mr. PRICE. The question I want to get to is, when a fiscal crisis occurs, when a debt crisis occurs, what is the triggering mechanism? What happens that results in that, the inability to borrow at an affordable rate as you described it?

Mr. ELMENDORF. I think a loss of confidence in the government's ability to manage its affairs, and to pay the interest on the debt makes potential investors more concerned, and makes them expect higher-risk premiums.

Mr. PRICE. Which is not a predictable moment in time, is that accurate?

Mr. ELMENDORF. That is right, Congressman.

Mr. PRICE. Thank you.

Chairman RYAN. Ms. Schwartz.

Ms. SCHWARTZ. Thank you, and welcome to a new budget cycle. Pleased to be back. And these are really keen and important debates that we are having for our country and I do want to thank you, Dr. Elmendorf, for being here and outlining where we are. You did point to some positive news. I appreciate that, the fact that we are in recovery, that you are seeing some very positive signs in economic growth in the housing sector, you pointed out. And that, of course, you have heard already the disagreement that is making it very difficult to find a way to actually reduce the deficit in a fair and balanced way that strengthens the middle class, that grows jobs, that does not hurt this fragile economic recovery. We have seen economic growth. We saw the arguments at the end of last year that saw a contraction in the economy for the first time in 3 years, was it?

Mr. ELMENDORF. Yes.

Ms. SCHWARTZ. So you know, that is significant. The debates we have here have an effect. And of course, we believe that this is not just politics. There are very different economic theories about how we grow this economy, how we strengthen the middle class, how we actually are economically competitive in a global marketplace, and how we meet our obligations, not only to our children and our future, but the obligations that you and I have talked a good deal about, and we talked about on this committee, and is that our seniors. And that is what I wanted to ask you about.

One of the things that we have seen again, positive news this week, you pointed it out, CBO has pointed it out, the Department of Human Services pointed it out, and some private sector institutes have pointed it out, that, in fact, we have seen slower growth in the costs of health care, in both the private sector and in the public sector——

Mr. ELMENDORF. Yes.

Ms. SCHWARTZ [continuing]. That is quite significant. When we came in here, we had double-digit growth in costs in the health care sector for a decade, 100 percent increase and more in both the private sector, and particularly in the private sector, more so than in the public sector, but in Medicare and Medicaid, I think that some of us would contend that we have seen these delivery system reforms and a very serious commitment that we have made to really push the health care system, both doctors and hospitals, to give us better value for our taxpayer dollar, to improve the quality of health care for our seniors, to deliver health care in a much more cost efficient way, and as a result, save taxpayer dollars and improve the quality of our seniors' health care.

So particularly given the demographic problems around Medicare, the baby boomers, 10,000 more seniors a day. It is serious business. But could you speak to the fact that you have found, again, we have seen other reports, that have said we have seen very good reduction. Three percent growth rate is really quite something, when we have seen 10 percent a year in Medicare.

I will ask you to confirm that, but I will also ask that as we move, which is the intention, we have legislation to do it as well, which is to move the way we pay physicians in this country, not just repeal SGR, but actually change the way we reimburse all physicians under Medicare, that would require them to pick a model that does save money and improve quality, and outcomes for our seniors, has the potential, and I hope can you actually document that we have said all physicians in this country move in that direction, the potential cost savings and cost containment, not only in the public sector, but also in the private sector.

Mr. ELMENDORF. Yes. Let me first quickly emphasize the point you made about the effects of the retirement of the Baby Boom generation, because the numbers are really quite striking. We think that, by 2023, there will be roughly 40 percent more beneficiaries of Social Security and Medicare than there were last year, 40 percent more people roughly. And that has a tremendous effect, obviously, on the overall cost of those programs.

Ms. SCHWARTZ. We made a commitment to those seniors that many of us expect us to meet.

Mr. ELMENDORF. Your point, Congresswoman, about health care cost growth has been absolutely right. There has been a market slowing in Medicare in Part A, that mostly pays for hospital care, and Part B, that pays for physicians, and part D, that pays for drugs, and in Medicaid, and in the private sector in the rate of health cost growth. We and other analysts think that part of that is because of the recession and the slow growth of income and loss of wealth that has reduced people's willingness to pay money for health care. But we think that a significant part of it is in fact structural. The crucial question is whether those structural changes are transient or will be enduring. And that is a topic that we are giving a lot of thought to and talking with outside experts. I think the right way to summarize the consensus is that we don't know.

Ms. SCHWARTZ. If we were to pass legislation this year, before the SGR expires or would go into effect again and see that kind of cuts, if we actually passed legislation, which honestly there has been really serious and good discussions between Democrats and Republicans on, on my bill, on an innovative way to pay physicians under Medicare, would that give you the tools to be able to say this is actually going to happen, this is the window when it is going to happen, this is the direction we are moving in?

Mr. ELMENDORF. I think there is widespread support, Congresswoman, for the idea that we should be paying health care providers in a different way than we are paying them today. And I think widespread agreement that a shift in how we pay providers can improve both the quality of care and keep costs down. Exactly what changes in Federal law will lead to what particular outcomes is a very uncertain business. And we look forward to continuing to work with you on that.

Chairman RYAN. Thank you.

Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman.

And good to see you again, Dr. Elmendorf. So large and persistent deficits like we have over the long term are a bad thing for economic growth, job creation, and potentially have the debt crisis risk that you discussed, right?

Mr. ELMENDORF. Yes, Congressman.

Mr. CAMPBELL. Okay. But the solution to that, which is some kind of fiscal contraction, be it either through tax increases or spending reduction, can cause a reduction in short-term economic growth and/or job creation.

Mr. ELMENDORF. Yes, exactly, Congressman.

Mr. CAMPBELL. So we are in a bit of a pickle.

Mr. ELMENDORF. Yes, Congressman.

Mr. CAMPBELL. So the question is, how do we get out of this thing? Now, in Europe, Greeks and Spanish and Italians waited too long, and they had to do a substantial fiscal contraction in a very short period of time, which resulted in extremely high unemployment and large contraction in their GDP. Is that correct?

Mr. ELMENDORF. Yes. Other factors have been at work as well, Congressman, but yes. We think that the sharp fiscal austerity in some countries in Europe have contracted their economies.

Mr. CAMPBELL. Right. If we were to decide to try and fix this whole budget deficit in the next 2 years, or if we were forced to do it by debt crisis, that would plunge the country into recession; unemployment would go up worse than it is today; bad things.

Mr. ELMENDORF. Yes, Congressman.

Mr. CAMPBELL. Okay. So we don't want to do that. But if we ignore it, or we only deal with just a little bit of it, and the deficits go on as you show in the baseline or even worse in the alternative scenario, then we risk never getting to our potential growth and potentially have that debt crisis where a few years from now we would have to make that kind of overnight contraction.

Mr. ELMENDORF. Yes, Congressman, that is a risk, absolutely.

Mr. CAMPBELL. So it makes a whole lot of sense to try and solve this thing in not too short a time and not too long a time, which—and I don't know whether you feel comfortable answering this or not, but if 2 or 3 years is too short and not dealing with it or looking at 30 years is too long, is somewhere in 8 to 12 years, if it were done in an even approach, is that the sort of thing that might be able to balance and get us out of this pickle with as little damage as possible and as much opportunity for growth?

Mr. ELMENDORF. I really don't want to prescribe a particular time path, Congressman, as you know. But I think you are absolutely right that the longer—the risk of waiting longer is that by running with a high level of debt to GDP, or a rising level of debt to GDP, the costs build up and the risks build up. And in 2007, debt was 36 percent of GDP. By the end of this year, it will have risen by 40 percent of GDP, we project, to 76 percent of GDP because of the financial crisis and the recession and the actions taken in response to them.

If we run at this higher level of debt and encounter another crisis, domestically or internationally, that room to expand the deficit will not be there in the way it has been over the last half dozen years.

Mr. CAMPBELL. Right. Okay. Just a couple other things here in my final couple of minutes. Mr. Van Hollen talked about the sequester and replacing it, 1-year cuts over something that will be over 10 years. If you were to replace the sequester with whatever, just a similar amount that matched year for year what the sequester is of other spending cuts and/or tax increases, now I understand the composition would have something to do with it, but if you do $100 billion in fiscal contraction, there is some negative impact on the economy no matter where that fiscal contraction comes from.

Mr. ELMENDORF. Yes, I think that is right, Congressman. You are just right that the timing is critical for the economic effects. The composition can also matter depending on just how you and your colleagues do it.

Mr. CAMPBELL. Right. But if we put it off, we are putting off the problem that we discussed we have to deal with. One final thing on tax expenditures—and I hate that term, but I know you economists like it. Let's call it tax deductions, credits, whatever. Is not the vast majority of those, if you look at home mortgage interest, charitable contribution, IRAs, 401(k)s, other retirement plans, and health care, isn't that where—I mean, if you really wanted to make a big impact, you would have to go into those things, would you not?

Mr. ELMENDORF. Congressman, you are absolutely right, those are the largest components. How big an impact one could make dealing with other pieces we haven't quite assessed. But in this nice chart we had last year, the single largest tax expenditure relates to health care, principally the exclusion of health insurance from taxable income. The second largest involves pensions. And the third largest involves mortgage interest.

Mr. CAMPBELL. Okay. All right. Well, thank you very much, Dr. Elmendorf.

Mr. ELMENDORF. Thank you, Congressman.

Chairman RYAN. Mr. Pascrell.

Mr. PASCRELL. Thank you, Mr. Chairman.

Dr. Elmendorf, thank you for coming before us again and opening up a pleasant season for the next 2 years. I think that I want to respond to my brother from Georgia, what he said before, about how we have increased spending since 2008, beginning January 2009, when President Obama raised his hand. I think we are all here to roll up our sleeves and find a long-term solution to the debt.

But just as we know that increased revenue is not going to solve the entire problem by any stretch, neither—we can't cut our way out of our budget difficulties either. So when you look at what has happened in terms of budgets since 2009, January 2009 and now, when there was an increase in spending—we can't just talk about that out of context. Why was there an increase in spending? Are we spending just to spend? Or was this the government's response, our response, whether you voted for it or not, to a very serious problem in the United States of America? People out of work, health care costs going through the roof. So how do we do it? No one else is spending. If we don't have private capital invested, and that started before the end of 2008, then how do you try to provide an atmosphere so that there is investment into the economy?

And we want private investment. We know the government can't solve every problem. We understand that very, very well. But when you talk about a balanced budget, of course, it is preferable. But are we to think that because we have this tremendous deficit problem going into 2009, that all that we needed to do was cut across the board in view of the social and cultural things that were going on in this country and, by the way, much of the world? Are we to think that if we simply cut and slashed that everything would be fine?

You have created a nemesis. You have created a situation where folks, you want folks to think that you want to protect their tax dollar when you know very, very well that in 2009, we had tremendous unemployment, and if the government didn't do anything, if there was no recovery—and we could point out chapter and verse where recovery helped in creating jobs, and not what happened in the last quarter of last year. Very interesting comparisons. So we had to come out of two wars; we never paid for them. We had to come out of two major tax cuts in 2001 and 2003; we never paid for that either. We didn't even pay for the prescription drug plan that we passed 8 years ago.

There is a reason why we had to spend that money. And if anyone is trying to imply here that if we simply stopped spending the money—isn't that wonderful? And it is our money. It is the taxpayers' money—that we would be in better economic shape, well, the American people didn't buy that in the last election. They just simply did not buy it. Because they are a lot smarter than we think they are, all of us included, both sides of the aisle, both sides of the aisle. So instead of a trickle-down economics, which you had for 8 years—and we will go into how many jobs were created then and how many jobs have been created over the last 4 years—instead of going to trickle down, we got a trickle up. I prefer trickle up. I prefer that the little guy have a shot at prosperity and not wait for the big guys to drive this economy, because they certainly flopped on their face in 2007 and 2008, when capital was not invested in this country.

Director Elmendorf, it seems to me that the most important way to achieve long-term deficit reduction is a balanced approach of revenue and spending cuts. That is what we keep on talking about. And in fact, according to your report this month, the CBO expects the deficit to shrink from 8.7 percent of GDP—because we don't want to quote these things because it doesn't fit into our script—that that will shrink to 5.3 percent. Is that correct?

Chairman RYAN. Thank you. Time has expired.

Mr. ELMENDORF. Yes, Congressman.

Mr. PASCRELL. Can he at least answer the question?

Chairman RYAN. You know, we got a lot of people here. He said yes. But if we wait until the clock is at zero to ask our question, we are not going to get to these other members who are waiting patiently for their turn.

Mr. PASCRELL. Your point is well taken, Mr. Chairman.

Chairman RYAN. Mr. McClintock.

Mr. MCCLINTOCK. Thank you, Mr. Chairman.

Dr. Elmendorf, let's get to some basics here first. In order to pay for spending, we either tax it now or we borrow it now and tax it later. Are there any other ways of spending, I mean other than monetary policy, which is itself simply a tax on existing capital?

Mr. ELMENDORF. Well, the amount by which you raise taxes later depends on the level of debt that you are willing to support the country.

Mr. MCCLINTOCK. But you either borrow it or you tax it if you are going to spend it.

Mr. ELMENDORF. Yes, Congressman.

Mr. MCCLINTOCK. All right. So government really cannot inject a dollar into the economy that is not first taken out of the same economy either by taxing now or borrowing now and taxing to repay it in the future.

Mr. ELMENDORF. I think, Congressman, under our current economic conditions, if the government borrows money, it is not taking a dollar out that would otherwise be invested. It can in fact increase the total demand for goods and services in the economy, and thereby boost employment and output.

Mr. MCCLINTOCK. If the dollar is being borrowed by the government, presumably it is not there then to be borrowed by a consumer seeking to make consumer purchases, or a home buyer seeking to reenter the housing market, or a small business seeking to expand jobs.

Mr. ELMENDORF. That logic is exactly right, Congressman, at a point where the economy is at full employment. But that is not the current economic circumstances.

Mr. MCCLINTOCK. Now, would you explain the economic impact of debt?

Mr. ELMENDORF. So, in a fully employed economy, of the sort that we project for the second half of the coming decade, then higher debt, as I mentioned, crowds out private investment and reduces incomes relative to what they would otherwise be.

And in an economy like the one we have today, the effects are starkly different. And in an economy like we have today, we think that additional borrowing to support higher spending or tax cuts would provide a boost to the economy in the short term.

Certainly if that extra borrowing is not paid down later, it will weigh on the economy later. But in the short term, it would provide a boost to the economy.

Mr. MCCLINTOCK. But you are borrowing a dollar from the same capital market that would otherwise be funding loans to consumers or to businesses or to home buyers, for example. So it is the same dollar. The only question is whether it is borrowed by the government to spend or is borrowed by somebody in the productive sector to spend.

Mr. ELMENDORF. But under current conditions, Congressman, the demand for private borrowing is very low. There isn't a conflict in the credit markets. That is why the Federal Government's interest rates are so low right now. Under other conditions, there would be more of a competition for funds of the sort you are describing. But these conditions are unusual.

Mr. MCCLINTOCK. I would suggest you talk to some small business people who are desperately trying to get loans or home buyers who are desperately trying to get loans, and they are telling us they can't get them. Now, tell us about the economic impact of spending—or pardon me, of taxes rather.

Mr. ELMENDORF. So taxes have two kinds of effects. One is they just take money that households would otherwise have to spend. The other is they can affect the incentives for people to work and to save. And in our macroeconomic modeling, we try to capture both of those sorts of effects.

Mr. MCCLINTOCK. In fact, didn't your office estimate that the tax increases back to the Clinton era rates on those earning $200,000 as individuals, $250,000 as couples, would cost about 200,000 jobs?

Mr. ELMENDORF. That sounds roughly right, Congressman. I don't remember the specifics. You are referring to our report I think on the fiscal cliff from last fall. I don't remember the precise numbers.

Mr. MCCLINTOCK. Now, we are also told by your office that the sequester reductions in spending would affect about 0.6 percent of growth, you said about 750,000 jobs, because government would not be spending that money on creating government jobs. But as we just established, government doesn't inject a dollar into the economy that is not first taken out of the economy. So I am afraid we are getting to a situation where we are being told that tax increases are bad for the economy, too much borrowing is bad for the economy, particularly in the future that you are projecting, and spending cuts are bad for the economy. And that doesn't leave us with many options.

Mr. ELMENDORF. So, Congressman, I think the effects of fiscal policy on the economy are different under different economic circumstances. That is a widely held, not universally held, but a widely held view among economists. And that is the perspective that we take. So under current economic circumstances, when private demand for goods and services is low, additional government demand through higher spending or the government spurring additional private demand through lower taxes can both increase the overall demand for goods and services and thus encourage businesses to hire more.

Under different economic circumstances, of the sort that we usually have in this country and we expect that we will have again 5 and 10 years from now, then this competition you are describing between the government's use of funds and the private sector's use of funds can become acute. And that is why under those economic circumstances smaller government deficits are good for the economy.

Chairman RYAN. Thank you.

Mr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

I have asked they put up a chart on the screen so that you can— a picture is always worth a thousand words.

And it is good to see you, Mr. Elmendorf. Your budget analysis is very interesting. For years we have had to listen to the Republicans lighting their hair on fire on cable TV about the temporary large deficits we have. We were told if Simpson-Bowles was not enacted, it would be the end of the year as we know it. Two years later, we are going right along. And in fact, if you notice on that chart, the jobs are going up. We have had 35 months of people increasing. And the only places you see dips, if you check them out, are when the Republicans began to play roulette with the budget, when they created chaos about whether we were going to pay our bills internationally, or we have these big fights we have on the floor; the unemployment goes up because business doesn't have any confidence. They are not going to hire anybody.

And it seems to me that what you said is that the long-term problems in this country really are about health care costs, as Ms. Schwartz has already pointed out. When I came to Congress in 1988, we were talking about the big problem that was going to come in 2011. Well, it is here. The Baby Boomers are now enrolling in Medicare, and it is going to go from 40 million to 60 million. And that has been absolutely predictable, and nobody wanted to deal with it until it is now. It is nothing new. It is not we are suddenly having massive spending, except we are honoring our commitments to the people in this country.

And it seems to me that the issue really here is whether we are going to tear the safety net out, say to seniors, we are not going to cover you. You are on your own. You and your family go find out whatever you want.

But what is interesting is I think we have a triumph to talk about. And I want to talk a little bit about that. Medicare spending, as I understand it, is flat per person. Is that correct?

Mr. ELMENDORF. I don't have those precise numbers in front of me, but you are certainly right, Congressman. It has slowed very sharply in the past few years from what it was before.

Mr. McDERMOTT. And in my reading of your analysis, at least you give some credit, if not a good bit of credit, to the fact that we enacted the Affordable Care Act. Is that correct?

Mr. ELMENDORF. So, Congressman, we have not attributed the slow down to any particular factors, like the Affordable Care Act. What we have said is that we think part of it is related to the recession; part of it is structural. The structural part can have a number of possible causes. One could be providers thinking about the current and incipient effects of the Affordable Care Act. But they are also driven by pressures from private insurers. I think providers are driven by their own sense that they are not providing care in as efficient a way as possible. And we have not tried at this point to—well, we tried to think through, but we have not said anything, because we don't know about what factors are driving those structural changes. If we understood better what factors were driving them, we would understand better what the prognosis was as well.

Mr. McDERMOTT. That is my point. If you pass a law, even the threat of passing the law, under the Clinton administration, suddenly health care costs kind of leveled off. And again, we see it when the Congress acts, that we basically see the flattening of costs.

Now you can't directly tie it, point A to point B, but you know that the whole United States is watching what the Congress is doing. And when we don't pay our debts, they stop hiring. That is clear. I mean, you can look right at the graph and trace it down to the time when it happened, and you can see how it happened.

I think that the thing that is most amazing about this is that the industry, the medical-industrial complex is actually responding because they know it is not sustainable. And my question to you is the effect of throwing people off of Medicare, or raising—let's raise the age to 67 or 70 before you can get on. What would that effect, how would that affect the economy? Do you have an idea?

Mr. ELMENDORF. Congressman, it depends a lot on what else is going on and exactly how that provision would be structured. We wrote a report early last year about the effects of raising the eligibility age for Social Security and for Medicare. And we talked about the consequences. Certainly some people who aren't on Medicare would end up on other Federal health care programs. Some people we think would end up without insurance. Some people would choose to work longer to maintain their employer-sponsored health insurance. There is a whole combination of responses that we think would occur.

Mr. McDERMOTT. So the real issue here is how do we control health care costs.

Mr. ELMENDORF. That is a very important question, obviously, Congressman.

Chairman RYAN. Mr. Garrett.

Mr. GARRETT. Greetings. And this will follow up on our private conversation initially, and maybe some of the points when I was out of the room with regard to interest rates. And so one number that I heard, maybe somebody threw this out to you, because you were saying that we are at here now, basically zero, right, projection over the 10-year, going up around three. And so the interest payment on the debt is going to increase during that period of time. I think the one number that you threw out to us is $1.1 trillion for a 1 percent increase in interest. You base that—you basically factor that in to your projections over the 10-year, going from zero up to——

Mr. ELMENDORF. Right. So the increase in interest rates that we show is the underlying feature of our projection of Federal interest payments.

Mr. GARRETT. Right. So one of the other uncertainties is the maturation dates that the Fed has on the securities going out, that it is inverted, right, between long and short. Do you take that into consideration as well? In other words, one of the numbers I heard was that you could look at a 3 percent increase—3 percent, you would look at around $140 billion increase in year one, and that would only last for 2 to 3 years as the maturation date changes for the securities. Are you with me on that?

Mr. ELMENDORF. So you are right, Congressman, that our projections of government's interest payments depend not just on the level of interest rates at that moment in time in the financial markets, but what the Federal Government has issued when, and when it is rolling over those maturing securities into new securities.

Mr. GARRETT. And so I guess one of the multiple bottom lines of this is we are going through the whole sequester issue trying to save roughly a hundred billion dollars, maybe $86 billion with interest payments, and that basically pales in comparison if interest rates go up just 1 percent.

Mr. ELMENDORF. Yes, that is right, Congressman. Now, a 1 percentage point higher level of interest rates in an entire decade would be a sizable change.

Mr. GARRETT. Well, we could do everything—well, a sizable change and a historically accurate change. In other words, we are at historically low numbers right now.

Mr. ELMENDORF. Yeah, I mean above and beyond the increase, I was suggesting that we have built into our projection, which is a return of interest rates to slightly above their historical average level. Further increases are certainly possible. But I am just noting a percentage point difference for the entire decade is a fairly large difference.

Mr. GARRETT. Let me turn real quick over to the FHA. The FHA revealed in their housing industry report that cash reserves are down 45 percent from last year, and chances of future losses on the current outstanding portfolio could exceed 50 percent is not out of the norm, which would require potentially that the taxpayers would have to bail out the FHA going forward. Further, the report shows from the FHA that they are overleveraged right now. They are at a leverage ratio of 400 to 1, which sort of makes Bear Stearns, Lehman Brothers, and the rest sort of—and the GSEs even—pale in comparison. Have you examined the FHA's report and the budgetary implications on that in your projections?

Mr. ELMENDORF. Let me say two things, Congressman, quickly. First, as you know, when you refer to a government bailout, there is no explicit action by the Congress that would be required. It is simply the case that if people don't pay back their mortgages and the FHA is on the hook, that taxpayers will suffer those losses.

Mr. GARRETT. They have a line of credit due the Treasury. They don't have to come to Congress, but the Treasury can basically give them the money without us authorizing. Did you take that into consideration?

Mr. ELMENDORF. Yes. The second thing I would say is that as you know, again to explain to others, there is a few years of FHA lending that has turned out particularly poorly in terms of delinquency and default rates. And we have not done a separate projection of what the draw on the Treasury might ultimately be. If there is a change, it would turn up, as you know, as a credit reestimate in the budget. But we don't have a specific projection that I am aware of, of what the FHA——

Mr. GARRETT. Would that be something that you could do and take a look at?

Mr. ELMENDORF. I think we could take a closer look at it, yes. We have to talk with you more specifically. And I don't know about the data that we can get. But yes, we could try.

Mr. GARRETT. That would be very helpful to us over in Financial Services and Approps as well.

So last question is with regard to Medicare. As you well know, there is a law in place that says when costs exceed revenues by 45 percent, something has to happen, right? That the President has to issue a report on how to solve the problem, correct?

Mr. ELMENDORF. Yes.

Mr. GARRETT. Okay. So has that ever been triggered?

Mr. ELMENDORF. So that threshold has been exceeded for a number of years, I think, Congressman.

Mr. GARRETT. Was that triggered in 2009?

Mr. ELMENDORF. I don't know the precise years, Congressman, but I would take your word for it.

Mr. GARRETT. Would you believe 2009, 2010, 2011, 2012?

Mr. ELMENDORF. I would believe it, Congressman.

Mr. GARRETT. Have you scored the President's proposal in response to that?

Mr. ELMENDORF. We have never scored a specific response to that. We have estimated the President's——

Mr. GARRETT. Has the President ever, as required by law, provided a report as required in the law?

Mr. ELMENDORF. I am not aware of any, Congressman.

Mr. GARRETT. So he has violated the law in that sense?

Mr. ELMENDORF. I am not a lawyer, Congressman.

Mr. GARRETT. But he was required to do so.

Mr. ELMENDORF. There is a requirement for a proposal to be made. I am not aware of any proposals having been made. I may be unaware, and I am not in a position of speaking to the legalities.

Mr. GARRETT. You would have scored it had he done it, would you not?

Mr. PRICE [presiding]. The gentleman's time has expired.

Mr. ELMENDORF. Well, it depends. As you know, we estimate the President's budget once a year. Otherwise, we estimate things that you and your colleagues bring to us, not the administration directly.

Mr. PRICE. Thank you, Dr. Elmendorf.

The gentlelady from California, Ms. Lee.

Ms. LEE. Thank you very much, Mr. Chairman.

First of all, let me just say it is an honor to serve on this committee. And I hope to work with this committee to create a useful road map for the American people, one that will create jobs, lift people out of poverty and into the middle class, grow our economy for everyone, and reduce the deficit.

And let me thank you, Mr. Director, for your testimony and for being here.

Our budget is not only a road map to fiscal responsibility, but it is also a moral document. It shines a light on what the priorities are of our government and who we are as a country. Our Nation's budget must reflect our values, and it must raise enough revenue so that we can invest in our people and meet our Nation's challenges head on.

While our economy continues to slowly recover, I believe we also must focus on lifting the millions of Americans who are living in poverty up the economic ladder and into the middle class. And so, in addition to looking at policies that strengthen the middle class, I will continue, as a member of this committee, to remind this committee that nearly 50 million people live in poverty; 16 million are children. And this is unacceptable.

Now, unless Congress acts by March 1, the sequester will slash thousands of jobs, which we have heard earlier, and economic security of the middle class, but it will also push the poor and low-income individuals really over the edge. It will eviscerate any gains our recovering economy has made in recent years.

So there is no question that we need to prevent these cuts from taking place, and we must do so in a way that protects investments that create and continue this economic growth. So I think we need to take a hard look at the loopholes and tax expenditures in our Tax Code that allow some of the wealthiest individuals and businesses to not pay their fair share.

But also we need to look at the ongoing waste, fraud, and abuse going on over at the Pentagon. And so, you know, I can't for the life of me figure out how we can budget when the single largest discretionary item on our budget cannot be audited. We need the Pentagon to pass an audit so we can get to know where the money and where our tax dollars are going, and adequately set priorities.

Now let me just ask you about the CBO report on the American Recovery and Reinvestment Act. I would just like to ask you, Mr. Director, can you explain how our government's targeted investment in the American people and in our Nation's critical infrastructure, how that created jobs and how it helped to begin to grow the economy?

And also, if we invested in a program that provided coordinated benefits in social services that lifted the long-term economic stability and incomes, let's say half the families living in poverty, what impact would that be and what impact would that have overall in terms of our economic growth?

Mr. ELMENDORF. So, Congresswoman, as you know, we have estimated consistently for the past 4 years that the Recovery Act, taking effect at the time it did with the economic circumstances the country faced, increased output and jobs relative to what would have happened in the absence of the Recovery Act.

And we think it did that by some additional direct government purchases, by giving money to State and local governments that they then used to purchase goods and services, or to provide benefits, and by cutting taxes to Americans that let them then spend more money themselves. And that additional demand for goods and services filled in part, only part, but part of the great shortfall in demand that had come about in the wake of the bursting of the housing bubble and the financial crisis. So we think the path of output and employment has been higher than it would have been otherwise because of that act. And we think that this year, with an economy stronger but not that strong yet, that easing of fiscal policy, such as a deferral of the sequester, would boost output and employment this year relative to what would occur under current law.

You also asked about longer-term effects of policy. I think those effects are ones that we worry about, but are harder to know for sure. So if the government can strengthen the economic—can strengthen people's skills, help them have better education and more training, that should make them more productive over time. But the overall economic effects will also depend on how the government does that and where the money comes from to do it. So spending a dollar in a certain place can be good for the economy, but in the longer run, it does come out of something else. And you think of the overall economic effects, we need to think about what it is coming out of in addition to what it is going into.

Mr. PRICE. The gentlelady's time has expired.

The gentleman from Oklahoma, Mr. Lankford.

Mr. LANKFORD. Thank you, Mr. Chairman.

Thank you. I want to be able to continue on that same line of conversation about the long-term impact. Is there an economic benefit to balancing our budget? Not adding to additional, let's say, principal year after year. Is there a benefit to our economic development as a Nation?

Mr. ELMENDORF. Well, I think, yes, Congressman, a smaller deficit, all the way down to zero, can be better for the economy in the medium and long run than a large deficit. But what the economic effect is ultimately depends on how you do that.

Mr. LANKFORD. How you get it. Right. I understand that, is the how you get there to the balance point also matters.

Mr. ELMENDORF. Yes.

Mr. LANKFORD. And that has to be done in a way that is judicious and that makes sense for the economy itself.

I interact with a lot of families that have a challenge of understanding this as they walk through the document. And they want to know how this applies to their individual family. So can you help bring that down to the individual family? What is the effect of a $16.5 trillion debt on a family? And what is the effect on how that grows, let's say as you mentioned, $7 trillion over the next 10 years? What effect does that have on an individual family? Now, I know you can't name the family and the address and say this family will lose their job, this family will benefit. I get that. But the overall impact on a family.

Mr. ELMENDORF. I think, Congressman, over the next few years, with a weak economy, the government borrowing in order to keep taxes lower and spending higher helps the average family by producing more demand for goods in the economy and thus increasing the chance they will be employed and get paid more.

But as you go into the second half of the coming decade, when we think people will mostly be back at work, then the government's borrowing is competing with the borrowing that households want to do for their mortgage borrowing. It competes with the borrowing that the businesses they work for may be trying to do. And at that point, that competition for borrowing makes it harder for businesses to invest. That will tend to limit the extra equipment that workers have to work with. And because of that, it will tend to lower their wages and their family incomes relative to what would have happened if instead the government had not been borrowing so much in the credit markets.

Mr. LANKFORD. Right. And that is not something you can just shut off and say, for the next 5 years, we are going to have the sugar high, and then once we get 5 years out, we are going to balance immediately, and then we will correct that. That is something that has to be corrected when?

Mr. ELMENDORF. Well, so balancing immediately would have the consequences we have been discussing.

Mr. LANKFORD. Right. I understand. That would be too risky.

Mr. ELMENDORF. The exact timing is a matter of trade-offs. And we have written about this before. The sooner that the Congress acts, the lower the level of debt is likely to be 5 and 10 years from now. On the other hand, the sooner the Congress acts, the greater the contraction would be in the short term.

Mr. LANKFORD. Short term and long term. This is, do you like it right now, or do you like it 5 years from now or 6 years from now?

Mr. ELMENDORF. Yes, that is right.

Mr. LANKFORD. Basically have to be able to deal with the consequences and the issues. So you are saying on the current path, we can postpone the pain for 5 years, but it is coming.

Mr. ELMENDORF. I think it is coming, yes, Congressman.

Mr. LANKFORD. Okay. Let me ask you a question about the size of the interest. We talk a lot about the interest rates and such. Project out. I mean you talk about another $7 trillion being added to the debt. What are we talking about of the actual dollar size of an interest payment based on your projection? Right now, we are paying around, give or take a few billion, around dollar $300 billion a year in interest payments. What is your best guess on getting out to the end of the 10-year window what we are paying in interest in a single year?

Mr. ELMENDORF. So, Congressman, our projection for this year, fiscal year 2013, is the government would spend $224 billion on interest payments. We project that would grow to $857 billion in 2023. That is an increase as a share of GDP from about 1.4 percent to 3.3 percent, or almost 2 extra percent of GDP devoted to net interest payments.

Mr. LANKFORD. All right. So current path, that is with the SGR cuts, that is with everything else——

Mr. ELMENDORF. Yes.

Mr. LANKFORD [continuing]. Current path by the end of the next decade, we are paying $857 billion just in interest.

Mr. ELMENDORF. Yes. Just in that single year.

Mr. LANKFORD. How many things do we have in our budget that are $857 billion?

Mr. ELMENDORF. Not very many, Congressman. It would be one of—there is a nice picture in our outlook—this would be one of the largest components of Federal spending. Those who have the outlook in front of you, figure 1-3, you can see that by 2023 the major health care programs as a group and Social Security as a group would be more than net interest payments, but the net interest payments would be higher than defense spending. It would be higher than all nondefense discretionary spending. And it would be higher than all mandatory spending, all the benefit programs apart from Social Security and the major health care programs.

Mr. LANKFORD. Thank you.

I yield back.

Mr. PRICE. Thank you.

The gentleman from Rhode Island, Mr. Cicilline.

Mr. CICILLINE. Thank you, Mr. Chairman.

I want to thank Chairman Ryan and our Ranking Member Van Hollen for the warm welcome, and look forward to serving on this committee.

And thank you, Dr. Elmendorf.

I think I have not heard from an economist or read the thinking of an economist who has not said that we have to approach this serious economic challenge by a balance of reducing spending and generating new revenues. And I think there is really no question that the President's articulation of that model is something that we have to do so that we both do it in a way that is properly timed but also which is at the same time making the investments that are necessary to grow our economy. But clearly we have to reduce spending, and so we are going to have to make choices about what we invest in. And so I am wondering if you would share some thoughts with us in terms of getting the most bang for our buck. What are the kinds of policies that, when we are engaging in spending, we are likely to produce the greatest economic growth and the greatest help to our economy? Because not all spending is the same. So, in that regard, in particular, I am interested to know your thoughts about infrastructure spending, really rebuilding the crumbling infrastructure of our country in sort of the old-fashioned WPA way, which leaves behind an asset which contributes to economic growth and our ability to move goods and services and information to compete in the global economy and, at the same time, puts people to work immediately but leaves behind a valuable asset. How does infrastructure in particular relate to economic growth when we are making choices about how to do spending? And secondly, if you would speak to a proposal the President spoke about last night, which is a proposal to allow millions of American homeowners to refinance their homes at a lower interest rate, the market rates today, which I suspect, not being an economist, would produce, on average, I think they said $1,200 a year in new spending opportunities for families, provide substantial economic relief, help stabilize the housing market. But I also expect it would be a huge economic generator in terms of job creation. So if you could speak to those two issues.

Mr. ELMENDORF. Yes, Congressman. So when we talk about bang for the buck, sometimes we talk about that in the short-term context and sometimes in the medium- or long-term context. And the interests can be different. In the short term, what matters most is how much of the extra dollar of government spending or how much of the lost dollar of taxes is spent and how quickly it is spent. Giving more money to spending increases or tax cuts to lower-income people tend to be more effective than doing the same for higher-income people because they tend to spend a larger share of the difference.

In infrastructure spending, a lot of that gets spent, but depending on the project, it may get spent somewhat slowly. So, in that sense, infrastructure can have a high bang for the buck ultimately, but it may not have as large a bang for the buck right now. Because certain projects just take a while to get started on.

In the medium term and long term, infrastructure investment, if devoted to high-return projects, can in fact have a big effect on the state of the economy. About half of nondefense discretionary spending can be viewed as investment either in physical structures or in people in the form of education and training. Not all that money is spent well, but some of it is clearly spent for things that the private sector would not otherwise provide. And some of those projects then can have high rates of return and can boost the economy in significant ways over time.

I think the one concern that people have raised about the cutbacks in discretionary spending as a share of GDP that are in place under the sequester, but even under the original caps, people have expressed concern that that can end up limiting the investment that the Federal Government does. Of course, it is hard to know for sure because you and your colleagues haven't made those specific choices yet.

On helping households to refinance in the way the President discussed last night, I don't know precisely what his proposal is. We will see that when he releases his budget. But we have in the past done analysis of different ways of encouraging more refinancing. We think that can have a positive effect on the economy in addition to helping those households. The overall effect depends crucially on how many households end up refinancing. So it depends crucially on how a program is designed, who is eligible, what the incentives are to households and to the lenders to do something differently than they are doing under current law. So the effects in the aggregate can vary a lot across different ways of doing that. But dollar for dollar, it can be effective, as we reported in a report about a year or so ago.

Mr. CICILLINE. When you say it depends on the amount, obviously the more Americans who are able to take advantage of it. If it is an easy program to administer, lots of eligible Americans, it will have a greater and more positive impact.

Mr. ELMENDORF. Yes. Exactly, Congressman.

Mr. CICILLINE. Thank you.

Mr. PRICE. The gentlelady from Tennessee, Mrs. Black.

Mrs. BLACK. Thank you, Mr. Chairman.

And thank you, Dr. Elmendorf, for being today. I think I can thank you for the this budget outlook, although it does, as you read through it, certainly bring up a lot of concerns about where we are going and the huge challenges that we will expect going down the road. And as I was reading through here, I made some notes where I see a lot of things are unsustainable. Social Security is unsustainable, and without reform, it will go bankrupt in 2033. Medicare is unsustainable. Hospital insurance trust funds end in 2023. Social Security Disability Insurance, which we don't talk very much about, and I think that is really an important topic that I would love to see either this committee or some other committee take a look at, because I got concerned about this last year when I started reading about it, it will go bankrupt in 2016. A big concern.

And then, on the education side, Pell Grants, $1 billion shortfall in fiscal year 2015, and then annual shortfalls of $5 billion or more from fiscal year 2016 through 2023. All of these programs, as we are looking at them, it is very, very scary to see that they are going to go bankrupt unless we have some form of reform.

But let me now turn to look at the health care issue, because CBO cites that rising health care costs as a leading driver of our debts and our deficits. And the Federal Exchange Subsidies alone are expected to cost $1.2 trillion, while the Medicaid expansions are expected to reach $638 billion. In knowing all this, will this increase in spending—well, first of all, the Affordable Care Act, or the ObamaCare, adds another trillion dollars in new health care entitlement spending. So here we go again, more health care entitlement spending. But will this increase in spending, with the Medicaid expansions and the new exchange subsidies, reduce health care cost growth as we look at the growth down the road?

Mr. ELMENDORF. Well, Congresswoman, the Affordable Care Act, as you know, had a number of different pieces with different sorts of effects. The expansion of insurance coverage we now estimate will cost $1.3 trillion over the 2013 to 2023 period, those 11 years.

Mrs. BLACK. And Dr. Elmendorf, let me just interrupt you there to make sure that I understand, this is $1.3 trillion more than what was anticipated in previous outlooks of the program. Is that correct?

Mr. ELMENDORF. No, no, Congresswoman. I am saying that the costs of the coverage expansion relative to a world that did not have that coverage expansion.

Mrs. BLACK. Okay.

Mr. ELMENDORF. There will be extra costs to the Federal budget of $1.3 trillion.

Mrs. BLACK. But extra costs.

Mr. ELMENDORF. We have made many, many changes to our projections of the costs of the Affordable Care Act coverage expansion, but they have netted out to actually very little change on balance for any given period of years. Our estimates through 2019 are now actually slightly below what they were when we first estimated the effects of that expansion 3 years ago. As one moves the budget window further along, though, then of course one ends up with larger numbers for this expansion, and for all, really almost all, existing Federal programs, and for tax revenue, because the economy is growing over time. So this particular part of the law raises Federal costs in order to subsidize health insurance for people in particular ways. The law also included changes to Medicare that have the effect of bringing down the growth rate of Medicare spending over time. Taking those pieces together, we think the law has increased the Federal Government's budgetary commitment to health care in the long run. Because ultimately those coverage expansions outweigh the Medicare savings, the law as a whole—in addition included changes in tax provisions—and as a whole we think it is a small deficit reducer. But the government's commitment to health care is increased because of the Affordable Care Act.

How those Medicare changes will affect the growth of Medicare spending we made our best estimate of, but it is an uncertain business. And whether those changes in Medicare would spill over to the private sector we don't know either. So we have not offered a view about whether the—and we don't do estimates of total national health expenditures. So we really tried to focus what we have done what we have said to the Federal budgetary effects.

Mrs. BLACK. And yet all of this, and I brought the chart up that you were actually referencing, this figure, to show that the major health care programs are the greatest amount of money that is spent in any one particular category. And we are showing that it does grow.

Mr. ELMENDORF. Yes.

Mrs. BLACK. It doesn't come down, it doesn't curve down and level out.

Mr. ELMENDORF. Yes.

Mrs. BLACK. It continues to grow. And yet despite this, and this is the point I want to make at the end of the day, is yet despite this, we know that there are going to be people out there, more people that will be uninsured than previously expected, because there are a lot of dynamics that are also occurring here that are going to cause that reaction that we will have more people uninsured.

Mr. PRICE. The gentlelady's time has expired.

Mr. ELMENDORF. I am sorry, Mr. Chairman, but we project that the law will greatly reduce the number of uninsured Americans relative to what would be the case without that law in force.

Mr. PRICE. The gentlelady's time has expired.

With apologies to the gentlelady from Florida for not recognizing her in order, Ms. Castor is recognized for 5 minutes.

Ms. CASTOR. Thank you, Mr. Chairman.

And thank you, Dr. Elmendorf, for being here today and sharing your economic budget outlook.

I think there are positive signs that should not be overlooked that our economy is growing and we are adding jobs. That is consistent with what I see back home in Florida. There is greater construction work and more cranes popping up across town. Housing prices are up. So if you are a seller, I guess that is pretty good news. We have a seen a significant drop in unemployment.

The tourism industry has rebounded quite strongly after the BP disaster. And if you are fortunate to have money in the stock market in the past few years, you have done very well.

Last year I asked you if you we had more people working across America, would our debt and deficit situation be largely improved? You said, yes. And I assume you still believe this is the case.

Mr. ELMENDORF. Yes.

Ms. CASTOR. Correct?

Mr. ELMENDORF. Yes.

Ms. CASTOR. But it seems like we still have significant headwinds to getting past that 7.5 percent unemployment rate. And in your outlook, in your early testimony, you said that you don't see great improvement there in the near term. So talk about the headwinds to greater employment across the economy, especially what is in the control of the Congress? What are the current policies that are in place that prevent us from lowering that unemployment rate?

Mr. ELMENDORF. So, Congresswoman, I think you described well a number of the factors that we see, underlying factors that are leading to economic growth. But as we have said, we think that the remaining parts of what had been the fiscal cliff of a few months ago, the remaining parts are still a substantial damper to economic growth this year. And one of the things that Congress might do to boost economic growth this year is to not let that fiscal tightening take effect. Of course, as you know——

Ms. CASTOR. Is this the sequester?

Mr. ELMENDORF. Yes. So there are a number of pieces of that, but one crucial piece is the sequester. And we think that if the Congress were to not have the sequester, then that would strengthen output this year and would lead to about 750,000 more jobs in the fourth quarter. At the same time, of course, as you know, that if there aren't offsetting changes made later, then that extra debt would become a drag on the economy in the medium term and long term.

Ms. CASTOR. That is what I am hearing from folks at home, our major employers. For example, we have a large port. If we reduce infrastructure spending, they anticipate cutbacks, and private businesses especially. Our large research university, they rely a lot on innovation and science and medical research. They are also telling me, along with the Cancer Research Institute, very significant damage to what they are doing, but a loss of jobs. Our large school district, the ninth largest school district in the country, and a large Air Force base, the MacDill Air Force Base, civilian workforce projection.

So, colleagues, we really—time is short. And I think what we are hearing today, if we want to address the debt and deficit, let's not do this to ourselves. Let's not self-inflict a wound that will set us back further, put us back, dig us in deeper on long term deficit and debt reduction. I think this is a warning sign, and Dr. Elmendorf is being very clear with us that we have got to work together and replace the sequester. That doesn't mean we are going to shirk our responsibility to address the long-term debt, the medium-term debt.

But if we are going to be stuck with this 7.5 percent unemployment rate, that is not sustainable, to borrow a word that has been used this morning quite a lot.

Dr. Elmendorf, are there other policies that could help us that are within the control of the Congress to create more jobs?

Mr. ELMENDORF. So, Congresswoman, you can think of them in a few categories. I think there are a number of changes in fiscal policy, higher spending, or lower taxes than are under current law. And we have done, as you know, a few reports in the past few years of trying to evaluate the bang for the buck of different sorts of changes in tax and spending policy. Turning off the sequester would be one item on that list, but there are other items as well.

Ms. CASTOR. Did you also mention immigration in your outlook?

Mr. ELMENDORF. So we don't talk about it in the outlook. Of course, we have done other work on immigration. I think immigration can be a very positive force—more immigration can be a very positive force for the economy in the medium term and long term, depending on exactly what the reforms were that Congress might consider. Those reforms wouldn't take effect quickly enough to provide a big boost to the economy this year and next year.

In terms of the short-term boosts, in addition to changes in fiscal policy, there are possible changes—I think just greater certainty about the course of fiscal policy would help. And maybe other changes that could be made as well.

Mr. PRICE. The gentlelady's time has expired.

The gentleman from Texas, Mr. Flores.

Mr. FLORES. Thank you, Mr. Chairman.

Dr. Elmendorf, thank you for joining us again. Let's talk about a different subject for a minute. When you looked at the President's budget from last year, can you tell me when that budget balanced?

Mr. ELMENDORF. In our estimate of it, Congressman, it never reached a balanced budget.

Mr. FLORES. Okay. And what would—would you say that the spending and revenue profile in that budget was one that would help create a sustainable economy?

Mr. ELMENDORF. Well, Congressman, we did think the economy would be sustained, yes. So we did an analysis of the economic effects of that budget. I don't remember the precise numbers. We still think the economy would be growing. But as I have said on many occasions, a path that had less government debt would by later in the decade and beyond lead to a stronger economy all else equal. And it depends on what else is occurring.

Mr. FLORES. Even the OMB by its own admission said that debt beyond the 10-year window was going to reach unsustainable levels, and the economy would suffer as a result of that.

What would the economic impact be if we were to raise taxes by $85 billion for the rest of this fiscal year starting on March 1 vis-a-vis having a $85 billion cut due to the sequester that also starts on March 1?

Mr. ELMENDORF. Well, Congressman, that would depend on the nature of the tax increase.

Mr. FLORES. Let's assume for a minute it is done through tax rates, tax rate increases.

Mr. ELMENDORF. I don't want to be difficult, it would still depend, as you know, on whose tax rates were cut. But in general, we think that——

Mr. FLORES. Let's just say we raised it on the top 1 percent again, include small business owners and——

Mr. ELMENDORF. So if the sequester were replaced by an equivalent dollar amount of increase in tax rates on high-income people, we would think that would be an improvement for the economy because we think that the propensity to spend of those high-income people would be smaller, dollar for dollar, than would be the spending that would arise from the sequester.

Mr. FLORES. So the lady on the corner that owns the dry cleaning store, when she has her taxes increased dramatically, is going to hire as many people and invest as much in the economy and continue with her expansion plans that she had prior to that tax increase?

Mr. ELMENDORF. Well, so I think, Congressman, that the lady on the corner would find that more people would come in with dry cleaning if they were the people who were working for the government or working on government contracts of the sort that would be increased by taking away the sequester. And I am not trying to play a game here, but I think that is the effect we have in mind, which is that what businesses are most concerned about now is weak demand for their products.

Mr. FLORES. So, I mean, under that line of thinking, what you do is you raise the taxes to 100 percent on high-income people, and then spend all their money on government contracts.

Mr. ELMENDORF. So, Congressman, you posed a particular question. We do try to be careful about extrapolating out.

Mr. FLORES. It was more rhetorical than anything.

How do you gauge the strength of this recovery over the last 4 years versus other economic recoveries post-World War II?

Mr. ELMENDORF. This has been a markedly weaker recovery.

Mr. FLORES. Okay. How does it compare to the recovery that we had during the 1981-1988 time frame? Or even you can go through 1993 if you would like to.

Mr. ELMENDORF. This has been a much weaker recovery than we had in the early 1980s.

Mr. FLORES. Okay. All right. The next thing, what was the 10-year cost of the Affordable Care Act when it was enacted? Do you remember that? Your cost estimates? Gross costs, not the deficit impact.

Mr. ELMENDORF. Yes, right. As you know, the deficit impact we thought was a slight deficit reduction.

Mr. FLORES. Right.

Mr. ELMENDORF. The cost of the coverage expansion may be what you are referring to over the 10-year window at the time. I don't know that number offhand. As I mentioned a little earlier, the number of the cost of the coverage expansion over that 10 years we now think would be smaller by a little bit than we thought at the time. But as you know, the budget window, the 10 years that we now provide projections for has moved out in time through 2023. And that increases the 10-year—the current 10-year cost defined in that way is higher.

Mr. FLORES. Okay. And again switching subjects for a minute, does the CBO look at unfunded obligations like what the actuarial obligations are of Social Security, of Medicare, Medicaid? Does CBO look at those?

Mr. ELMENDORF. Yes, Congressman. So, in our long-term budget outlook, we include the cost of those programs, and we include comments on the Social Security Trust Fund and the Medicare Hospital Insurance Trust Fund.

Mr. FLORES. But do you discount those back and say, this is what the net unfunded obligation is for Social Security today?

Mr. ELMENDORF. Yes, we do, Congressman.

Mr. FLORES. Okay. Do you have those numbers off the top of your head?

Mr. ELMENDORF. I am sorry, I don't. It is substantial, Congressman.

Mr. FLORES. It is tens of trillions of dollars between Social Security and Medicare. Correct?

Mr. ELMENDORF. I think that is right. We talk about this usually as a share of GDP, because we think that is a useful way to measure the burden on the economy.

Mr. PRICE. The gentleman's time has expired.

The gentleman from New York, Mr. Jeffries, is recognized for 5 minutes.

Mr. JEFFRIES. Thank you, Mr. Chairman.

You were just asked whether this has been a more robust or a weaker recovery than the ones I guess post-World War II, including the ones in the 1980s. And I think you testified that this was a weaker recovery. Is that correct?

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

Mr. JEFFRIES. Would it also be fair to say that in 2008 this country confronted the worse economic crisis and collapse that we have experienced in the history of the republic with the exception of the Great Depression?

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

Mr. JEFFRIES. Okay, and the economy, since 2009 under this administration, is moving in the right direction based on any reasonable objective economic measure, wouldn't that be correct?

Mr. ELMENDORF. So the GDP has been growing since the summer of that year, yes, Congressman.

Mr. JEFFRIES. Let's take a look at some other numbers. So 6 million private-sector jobs have been created over the last several years, is that correct?

Mr. ELMENDORF. Yes, I think so, Congressman. It depends on the point at which you start that tally.

Mr. JEFFRIES. Okay, and I believe about 500,000 manufacturing job have been created in America over the last few years, is that right?

Mr. ELMENDORF. That may be. I don't know that offhand.

Mr. JEFFRIES. Okay, I think unemployment, the unemployment rate is at or near its lowest level in the last 4 years, is that right?

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

Mr. JEFFRIES. Okay, and home prices are rising at the fastest rate in the last 6 years, is that correct?

Mr. ELMENDORF. Yes, Congressman.

Mr. JEFFRIES. And I think home purchases are up approximately 50 percent at this point in time?

Mr. ELMENDORF. They are rising a good deal. I don't know the exact number.

Mr. JEFFRIES. And I think we have also reduced the deficit by about $2.5 trillion in the last several years, is that correct?

Mr. ELMENDORF. Sir, we have not tried to do a calculation like that. How much has been accomplished so far depends very much on the point in time at which one starts counting, and the benchmark one is comparing to, so we have not done that calculation ourselves.

Mr. JEFFRIES. Okay, so it seems though, based on, you know, any reasonable economic measure, the economy is clearly moving in the right direction.

The question has been asked a few times today, is there any economic benefit to balancing the budget? I would like to ask a different question. Is there any economic benefit to simulating economic growth in the country at this moment in time?

Mr. ELMENDORF. Yes, Congressman, there is.

Mr. JEFFRIES. And what would be the best way, in your estimation, as you have examined this question, to stimulate economic growth?

Mr. ELMENDORF. Well, so the ultimate choices depend on people's judgments, your judgments, on behalf of your constituents as to what you think the government should or shouldn't be doing. But we have said that we think cuts in taxes or increases in spending that put money into people's hands where it is spent quickly, can provide a crucial boost to the demand for business services and encourage businesses to hire workers, which then gives them income, which allows them to spend more, and so on.

Mr. JEFFRIES. And you have indicated that the best way perhaps to increase consumer demand is to make sure that we increase the amount of money that is placed into the hands of low income or modest Americans, is that right?

Mr. ELMENDORF. I think in terms of the bang for the buck, lower income Americans tend to spend a larger share of extra money they get, or reduction in taxes that they enjoy.

Mr. JEFFRIES. And do you think it would be reasonable to conclude that an increase in the minimum wage, that was proposed recently by the President, and has been advocated by others, which would therefore place a greater degree of money in the hands of low income or modest income workers would lead to an increase in consumer demand, and therefore be good for the economy?

Mr. ELMENDORF. We have not studied a particular increase in the minimum wage carefully, Congressman. I think there are various specs at work. I think you are right, some people would get paid more, which they could then spend and would presumably spend. It is also true, though the evidence is mixed, we think there would probably be a small reduction in employment because the cost of workers would go up.

We have not tried to work through those effects or others. It also, of course, depends on how much the minimum wage is increased, and how the increase compares with what is the current minimum wage in many States, and in many States, of course, there is different minimum wage, a higher minimum wage than the Federal minimum.

Mr. JEFFRIES. I think the greatest reduction in employment at least that we could possibly face in the short term would be to allow the sequestration to take place, is that correct, we would loss about 750,000 jobs in your estimation?

Mr. ELMENDORF. I think, again, the Congress could examine a range of fiscal policy options, but of the things that are about to happen under current law that you all talk about a lot, the sequester, taking away the sequester would have a noticeable effect, in our judgment, on output and jobs over the rest of this year.

Mr. JEFFRIES. Now, you mentioned that a loss in confidence in the government's ability to manage its affairs could trigger the fiscal crisis where our ability to borrow at affordable rates is reduced, is that right?

Mr. ELMENDORF. Yes.

Mr. JEFFRIES. And would it be reasonable that confronting a fiscal cliff in January, a potential debt ceiling default, in March sequestration, debt ceiling default in February, sequestration in March, government shutdown in April, another potential debt ceiling default in May, could perhaps shake the confidence of some investors in our ability to deal with our responsibilities?

Mr. ELMENDORF. Yes, Congressman. We think that perennial crisis mode of fiscal policy over the past few years is reducing people's confidence. How big an effect that is, we don't know.

Mr. PRICE. The gentleman's time is expired. The gentleman from Indiana, Mr. Rokita.

Mr. ROKITA. Thank you, Mr. Chairman. And thank you, Doctor, for being back with us. I think by anyone's objective measure in this town or country, we would consider you a smart man, an intelligent man, a good economist, right?

Mr. ELMENDORF. I can't comment on that.

Mr. ROKITA. That is why it befuddles me, although it is certainly the member's privilege and prerogative, it strikes me that some of us want to speechify rather than use this precious time to engage you in conversation through some questioning. And that is, for the record, I would like to say, I really appreciate Mr. Jeffries' line of questioning. I will try to continue on in that regard.

Speaking of speechifying, we have heard that it is impossible to get ourselves out of this debt situation through spending cuts alone. And I just want to understand if I am correct that the CBO projects that revenue will double from 2012, the 2012 level at $2.4 trillion to $5.0 trillion by 2023?

Mr. ELMENDORF. Yes, Congressman.

Mr. ROKITA. Okay, and that this year alone, revenues will grow my $259 billion from the previous fiscal year level?

Mr. ELMENDORF. Yes, Congressman.

Mr. ROKITA. Yes. According to your report, revenues have averaged just under 18 percent of the economy in recent history. Am I correct that you project under current law that revenues will rise to over 19 percent?

Mr. ELMENDORF. Yes, Congressman.

Mr. ROKITA. And isn't that above the historic average since World War II?

Mr. ELMENDORF. Yes, Congressman.

Mr. ROKITA. Am I correct that in a letter you wrote to Mr. Boehner last year, you estimated that the President's Affordable Care Act, or Obamacare will increase revenues. I would say "taxes," but increase revenues by a trillion dollars?

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

Mr. ROKITA. Yeah, and that is because why?

Mr. ELMENDORF. That is because the law included a number of changes in tax rules that collect more money.

Mr. ROKITA. Increase taxes, in other words.

Mr. ELMENDORF. Yes, yes, exactly.

Mr. ROKITA. I think most people are focused on the tax increases that hit higher income tax payers. But am I correct that the payroll tax holiday expired as part of the fiscal cliff deal or not being included in the fiscal cliff deal?

Mr. ELMENDORF. Yes, yes.

Mr. ROKITA. Okay, great, thank you. Now, when you talked in your opening remarks to the public debt, I think, interject if I have these numbers wrong. You said that the public debt was 76 percent of our gross domestic product, the value of goods and services this whole country, man, woman, and child generates in a year?

Mr. ELMENDORF. That is the projection for end of this year, yes, Congressman.

Mr. ROKITA. Seventy-six percent. But going back to Mr. Flores' line of questioning, that is not the whole picture, right? I mean, go through the definition of public debt and why I think it might be higher that if you include what is missing from the Social Security Trust Fund, et cetera.

Mr. ELMENDORF. So in addition to the debt that is held by private citizens here and abroad, and by the Federal Reserve system, there is also a substantial amount of government debt that is held by other government accounts, the most prominent of which, the largest of which is the Social Security Trust Fund. That debt is honest-to-goodness government debt, backed by the full faith and credit of the government. We don't include it in the debt measure that we focus on, nor do most analysts, because we and most analysts look at the government as a unified whole, and when we do projections of future spending, we take account of future Social Security and Medicare, other components of spending, so we capture the future obligations of those programs under current law in the way we do our projections of spending.

Mr. ROKITA. So we——

Mr. ELMENDORF. So when we look at the debt, we look at the debt the government owes to outside the government.

Mr. ROKITA. So you don't calculate that debt until that debt becomes due, so when the Social Security Trust Fund has an IOU and gives it to the other hand of government to pay that IOU, that is when you count it, at that time, right?

Mr. ELMENDORF. Yes, and as you know, we actually produce projections of this larger—of gross debt. We report them in this outlook, but we don't focus on them.

Mr. ROKITA. If I wanted to include the Social Security Trust Fund in my remarks to constituents, and trying to educate America to what is really happening here, what would be the debt-to-GDP ratio if you included the trust fund and any other significant debt?

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

Mr. ROKITA. Do you think it would be over 100 percent?

Mr. ELMENDORF. That seems plausible, yes, Congressman.

Mr. ROKITA. Okay, thank you. And with the remaining time I have, and remember, when I started my questioning, I complimented you about how smart you were, certainly relative to me, so take you in this vein. If I was a taking your credit card application, your personal one, and under the question, occupation, would it be plausible for you to tell me you are an economist?

Mr. ELMENDORF. Yes, Congressman.

Mr. ROKITA. Okay. So you are familiar with the Austrian School, the Chicago School——

Mr. ELMENDORF. Yes, Congressman.

Mr. ROKITA [continuing]. The Keynesians, the neo-Keynesians and all that?

Mr. ELMENDORF. Yes, Congressman. You and I have discussed this before, I think.

Mr. ROKITA. Okay, which one do you prefer, and why are the other ones inferior, which school?

Mr. ELMENDORF. So I think the consensus view in the economics profession, is that what people think of as Keynesian economics, which is the output in employment depend on the demand for goods and services, answers important questions about what will happen in the economy when unemployment is very high, as it has been over the past several years, but the consensus also thinks that over the medium term and long term, when unemployment is not generally so high, that what we think of as neoclassical economics is a better guide to what happens in the economy.

Mr. ROKITA. And even Keynes thought that you have got to stop the spending at some point.

Mr. ELMENDORF. I don't know.

Mr. PRICE. The gentleman's time has expired.

Mr. ROKITA. My time is expired, I am told. I yield back.

Mr. PRICE. The gentleman from Wisconsin, Mr. Pocan.

Mr. POCAN. Thank you, Mr. Chair, and thank you, Dr. Elmendorf. It is a pleasure to be on the committee, especially with so many people from Wisconsin. I know Mr. Ryan and I share a county. Back home we have neighboring districts. So it is great to be here representing my State.

Dr. Elmendorf, you know, one of the top priorities, as I look at it, is growing the economy. How can we create more jobs right now to really get things going? That is the best way to get out of the deficit situation, and when, you know, especially before being here, watching the news, it seems like all they ever talk about is deficit reduction as the economic plan as if Congress can't walk and chew gum. And I think we can do both.

And part of that is how do we help grow the economy to help create those jobs. When I was on our joint committee on finance back home in the legislature, I used to be the chair of the committee, and we had to approve every single recovery dollar that, stimulus dollar that came through Wisconsin that came from Congress. And at that time, you know, anecdotally I have a small business. I heard from small business owners who benefit from it, but more importantly, at that committee we had the road building industry, and the vertical construction industry.

So, you know, road building, and building, buildings—not exactly your most liberal entities—put out a report saying that 54,000 jobs were saved or created just in the State of Wisconsin, thanks to those stimulus dollars, and some other minor things we did in the legislature. And you know, I look at that and then I look at what the President said yesterday about kind of investing it back again. And then I saw a release from Speaker Boehner yesterday, and he said in his release, tonight he offered them little more than the same stimulus policies that have failed to fix our economy and put Americans back to work.

And you know, I know Wisconsin is a very unique place because those of us from there are very proud to be from there. I think we have very commonsense Midwestern values, but our experience was very different than that comment. I was just curious. I believe the CBO has done a report on the ARRA effects. Were there, indeed, is it unique to Wisconsin or were there total job increases across the country because of those investments?

Mr. ELMENDORF. So Congressman, we think that there were more, there were more jobs and more output produced because of the Recovery Act.

Mr. POCAN. And what kind of numbers jobs are we talking?

Mr. ELMENDORF. So it varies over time because the spending and the tax reductions from the Recovery Act varied over time. At the peak effect of the Act, in 2010 and 2011, we think there were between basically half a million and 3.5 million additional jobs.

Mr. POCAN. Okay, so up to 3.5 million. And then were there additional jobs since then through that peak period?

Mr. ELMENDORF. Yes, so there continues to be, in our estimate, slightly more employment than would otherwise be the case. But most of the money from that, both the spending side and the tax cuts has now been spent, so the effects are dwindling.

Mr. POCAN. So because of the job increase, I think it is fair to say, too, that it reduced the unemployment rate during that period?

Mr. ELMENDORF. Yes, Congressman.

Mr. POCAN. Okay, and how about the effect on economic growth in that period? Did it have any net effect to the economy?

Mr. ELMENDORF. Yes, we think it boosted economic growth in 2009 and 2010 by a considerable extent and brought down the unemployment rate again, particularly, in 2010 and 2011.

Mr. POCAN. Okay, so you know, I just think as we look at what we are talking about, you know, so often people talk about whether you raise taxes or you cut spending, as if those are the only two alternatives on the table, and I think maybe sometimes in Washington, those are the only two alternatives people seem to look at. But from those of us who come from the heartland or maybe are new around here, you know, I have had a small business since I had hair, and it was dark. All right, so I come from a little different perspective, but it does seem that there is another way that if we can actually help to increase people getting to work and getting jobs and if they are paying taxes, that trajectory we saw on spending is the problem on that chart, we could start to then close up that trajectory by bringing in real revenue without raising taxes on anyone just by having more people becoming taxpayers. Is that a fair assessment?

Mr. ELMENDORF. So you are right Congressman, that if more people worked and they earned more money, that could have a substantial positive effect on the budget. The question is what policies the Congress might enact and what the cost of those policies would be for the budget.

Mr. POCAN. Got you. And then when people have talked about, too, you know, when there is a dollar expended to do that, I mean, just like in business, if I invest in something you have got a cost to do that, but I would make a profit off of that ultimately. So there may be a 20, 40, 60, 80 percent, whatever the cost is depending on their product, ultimately, you still could have a net gain, correct? So having that investment, if it is the right policy and it creates jobs, can help close that trajectory?

Mr. ELMENDORF. It is possible, Congressman, but if the government invests in something, even if that project earns a fairly high return for the economy as a whole, the government will collect only a small share of that higher return in future tax revenue. So funding projects that would pay for themselves by the Federal Government, I wouldn't want to rule out. But on the other hand, I think you should view that as a very high bar——

Mr. PRICE. The gentleman's time is expired. The gentleman from Georgia, Mr. Woodall, is recognized for 5 minutes.

Mr. WOODALL. I thank you, Mr. Chairman, and I want to say how proud I am that we have a Georgian sitting as vice chairman of the committee this cycle. My freshman colleague from Wisconsin talks about commonsense Midwestern values. It is those commonsense Georgia values that they give me great hope off of this institution. So congratulations to you in that new role.

So I do want to talk about the common ground we have with Wisconsin. In fact, Rhode Island, the gentleman from Rhode Island, Mr. Cicilline was talking earlier about the great public works programs, and before we started our questioning, and I just wanted to read from FDR's State of the Union speech back in 1935 when he said: "I am not willing that the vitality of our people be further sapped by the giving of cash or of market baskets. We must preserve not only the bodies of the unemployed from destitution, but also their self-respect, their self-reliance, their courage and their determination."

He called the payments going out at that time a narcotic, a subtle destroyer of the American spirit. And I would certainly hope as we talk about revenues, and I think about refundable tax credits as being these cash payments, anything we can do to work together to redirect those cash payments into those real jobs that provide real benefits to the human spirit, not just to the pocketbook, I would look forward to working together on. But thinking about my common Georgia upbringings, Director, I wanted you to help me with some things.

I heard a lot of discussion about, we can't get to balanced budgets just by cutting spending. There has to be a revenue component. And my friend from Indiana pointed out that revenue was going to double over the next 10 years under your projection?

Mr. ELMENDORF. Yes, Congressman.

Mr. WOODALL. So our revenue component, if we do nothing more, we are going to double revenues to the Federal Government over the next 10 years?

Mr. ELMENDORF. Yes, Congressman, that is our projection.

Mr. WOODALL. Now, thinking about the cutting of the spending that we are going to be doing over the next 10 years, if we do nothing over the next 10 years, how much will spending fall below current levels?

Mr. ELMENDORF. In dollar terms, Congressman, as you know, we expect the spending at the end of the decade will be quite a bit higher than spending is now.

Mr. WOODALL. Well, you say in dollar terms. What if we did it as a percentage of the economy to adjust for inflation, then how much lower would spending be in 10 years than it is today?

Mr. ELMENDORF. Well, as a share of the economy, we project outlays in 2023 will be 22.9 percent, and last year they were 22.8 percent.

Mr. WOODALL. So over the next 10 years, they are not going down either?

Mr. ELMENDORF. There is a dip and then there is an increase again.

Mr. WOODALL. Okay. So just to be clear, tax is going to double over the next 10 years in real dollar terms, spending not going to decline over the next 10 years either in real dollar terms, or nominal dollar terms?

Mr. ELMENDORF. That is right, Congressman. That is right. As you know, as I mentioned earlier there will be roughly 40 percent more beneficiaries of the largest, most expensive Federal programs a decade from now than they are today, and that is a critical factor driving those numbers.

Mr. WOODALL. Unquestionable, which leads me to believe, when you have serious people looking at these issues as we do, that no one is actually talking about cutting spending. We are just arguing about how much more we are going to increase spending. Are we going to increase a whole lot more? Are we going to increase it a little more because there are folks out there that we have to keep commitments to. As useful as I find the baseline, I can't tell you how much I appreciate the work that you do. I am glad that you do it instead of me doing it. I tell folks, the best part of my job is really smart people are willing to invest time in me to make me smarter.

But something I don't understand. You mentioned in your testimony that the alternative fiscal scenario assumes the sequester doesn't go into effect because you have had some members mention that. But does the baseline assume that the war in Iraq and Afghanistan comes to an end and that money ceases going out the door?

Mr. ELMENDORF. No. So what we do for, and have done for years——

Mr. WOODALL. Maybe a follow onto that. Does it assume that the Sandy supplemental spending was just a one-time effect and also won't go on?

Mr. ELMENDORF. No, Congressman. The answer to both parts of the question is that our projections of discretionary spending have never been about the cost of doing particular sorts of programs. They have always been extrapolations of the latest funding Congress has provided, with the one crucial exception now of the caps on most discretionary spending. But the current funding for overseas wars and the funding that Congress has provided for, really to Hurricane Sandy, we have extrapolated those with inflation, the way we have traditionally done discretionary spending as a whole.

Mr. WOODALL. And why is that? I mean, here we have done an alternative scenario because some Members have suggested that something might happen, and yet we baked into the baseline, 10 years of Sandy aid, which we know with absolute certainty will never happen. What is the reason for that?

Mr. ELMENDORF. So Congressman, I think for the things that, as you know, our table of alternative policies includes numbers that allow you and your colleagues to subtract those particular provisions if you would like, to construct your own projections of the budget balance. The reason we view those as somewhat different from the provisions in the alternative scenario, is the alternative scenario has a set of permanent features of law that the Congress has, in the past, extended or deferred taking effect. Whereas discretionary spending, as I said, has never been about particular programs, so we have written other reports, for example, on veterans' health care, which is indiscretionary spending. We think that providing the level of care people now get to the people who are now eligible will be more expensive 10 years from now than is captured in the discretionary baseline.

Mr. PRICE. The gentleman's time is expired.

Mr. ELMENDORF. Hurricane Sandy may not recur, but other storms may come, other wars may come. So we try not to judge what the level of discretionary spending that you all would like to have in the future.

Mr. PRICE. The gentleman's time is expired. The gentleman from California, Mr. Huffman.

Mr. HUFFMAN. Thank you, Mr. Chairman, and it is an honor to serve with you on this committee. Thank you, Dr. Elmendorf for your testimony. It has been very useful. I have a pretty quick question here. We have spent most of our time today discussing the deficit, our debt, and the health care costs that are the big driver of future expenditures. But a couple of my colleagues have brought up Social Security, and so I just wanted to ask you, Dr. Elmendorf, if you could please explain the extent to which Social Security contributes to the deficit and the public debt that we saw illustrated on the chart. And also, if you assume that we should be focused like a laser beam on bringing the deficit down so that we can get our debt under control, would you agree that the discussion of reducing Social Security costs is a bit of a red herring?

Mr. ELMENDORF. So Congressman, starting a few years ago and continuing indefinitely into the future under current law, the Social Security benefits that are being paid out exceed the Social Security tax revenues that are being collected. The Social Security Trust Fund also receives, as you know, interest payments on the debt that it holds. So at this point in time, Social Security benefits, as I said, are greater than tax revenue, a little less than the tax revenue plus the interest payments, but on a unified budget basis, where the interest payments from one part of the government to the other wash out, Social Security taxes benefits and taxes actually are increasing the budget deficit. And if you look in our projections out half a dozen years or so, by that point, the benefits will exceed the tax revenues plus the interest payments that will be paid in, so that the Social Security Trust Fund as a whole will be suffering annual deficits.

Mr. HUFFMAN. At what point—excuse me, at what point does Social Security begin to contribute to the deficit?

Mr. ELMENDORF. Well, again, Congressman, on a unified budget basis, taking account of just the tax revenues, the dedicated tax revenues, and the benefits, it is contributing the deficit now. If one instead looks at just the balance in the Social Security Trust Fund, that balance is, the annual balance is positive now, but will be negative within about a half dozen years. I am looking for the exact number and I can't find it, but it is changing quickly.

Mr. HUFFMAN. Okay.

Mr. PRICE. The gentleman yields back? The gentleman yields back his time.

Mr. ELMENDORF. Actually, Mr. Chairman, I do have the number to fully answer the question. Which is we think that by 2021, the Old-Age and Survivors Insurance Trust Fund will have an annual deficit. The Disability Insurance Trust Fund is currently an annual deficit. Taking those pieces together as people often do, we think the overall Social Security Trust Funds will be running annual deficits beginning in 2017.

Mr. PRICE. Thank you. The gentleman from Ohio, Mr. Renacci.

Ms. MOORE. Excuse me, Mr. Chairman.

Mr. RENACCI. Thank you, Mr. Chairman.

Mr. PRICE. The gentlelady from Wisconsin.

Ms. MOORE. I do have time constraints, and I do believe that I have been overlooked.

Mr. PRICE. The gentlelady is up following Mr. Renacci.

Ms. MOORE. Well, is he, how many Republicans have we taken?

Mr. PRICE. We have gone back and forth, Republican, Democrat. Mr. Huffman just had the time.

Ms. MOORE. Okay, I am so sorry.

Mr. PRICE. That is all right. The gentleman from Ohio.

Mr. RENACCI. Thank you, Mr. Chairman, and thank you, Doctor, for being here. I just want to go back to my colleague's question on Social Security because I do have a question on it. But the CBO baseline shows, and you previously mentioned that Social Security will run a cash deficit of $1.3 trillion over the next 10 years. Is that a true statement?

Mr. ELMENDORF. That may be, Congressman. I don't have that number in front of me, I am afraid.

Mr. RENACCI. Okay, going back to some of the discussions that have occurred, and it has been an interesting day for me. I have been a businessman most of my life, only been here a couple of years. So when I look at the business of the Federal Government as to how it is going, and how my current business is ran, my small business is ran back home, I would be scared to death of the trajectory direction that we are going. And I think you said that continuing under the current policies, it is just not sustainable, is that correct?

Mr. ELMENDORF. Yes, Congressman.

Mr. RENACCI. Okay. One question earlier, somebody talked about jobs, net jobs created over the last 4 years. Is that a negative number or a positive number, net jobs?

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

Mr. RENACCI. Okay. Let's go back to tax rates. And again, as a business owner, when my tax rates increased, I was concerned and would not employ more people. That was an easy answer for me. And if I didn't have any certainty and predictability of what those rates were going to be, I definitely didn't do much as far as the future. Do you have any correlation to the raising marginal rates and how it affects the economy, because we have talked a little bit about that?

Mr. ELMENDORF. Yes, Congressman, so when we modeled the effects of big changes in fiscal policy like the President's budget proposals each year, our models explicitly include the effects of changes in tax rates on people's work effort and on our saving behavior. We recently did a reexamination of the assumed amount of response that we have with a lot of consultation with outside experts, and made some adjustments in what we do and published reports describing how we read the evidence. But it is certainly the case, in our view of the research literature, that higher tax rates will tend to discourage work effort, and saving.

Mr. RENACCI. So as we talked about earlier, you heard that if we—if we add taxes, if we do a balanced approach, when marginal tax rates go up, that is also going to slow the economy down?

Mr. ELMENDORF. That is right, Congressman. Again, all else equal. So the crucial question is what else is going on in the Federal budget.

Mr. RENACCI. Do you think that comprehensive—well, actually, let's go back to the fiscal cliff. When we passed the fiscal cliff here recently, do you think people moved their taxable income? Was there a shift in taxable income and a change in what they were going to do knowing the rates were going up?

Mr. ELMENDORF. Yes, Congressman. I think that both corporations and individuals behaved differently the last part of last year, not—based on their expectation and their uncertainty about what was going to happen with the fiscal cliff.

Mr. RENACCI. So we will see a jump up maybe in receipts this year because of that?

Mr. ELMENDORF. And in fact, Federal receipts were strong in January, and that may be—that is, I think, part of the story. There is also, of course, the end of the temporary reduction in the payroll tax, and other factors.

Mr. RENACCI. Let's talk a little bit about capital gains, which I know also changed. Capital gains rates could lead to—in 2012, JCT and the CBO said that higher tax rates on capital gains could lead to a level of inefficiency and conversely, lower capital gain rates could, in fact, encourage investment. Do you agree with that statement?

Mr. ELMENDORF. Yes, Congressman.

Mr. RENACCI. Do you believe an increase in the capital gains tax could increase the long-term productivity.

Mr. ELMENDORF. So you said the——

Mr. RENACCI. Increase.

Mr. ELMENDORF. Increase.

Mr. RENACCI. Assuming that we are increasing capital gains.

Mr. ELMENDORF. All else equal, Congressman, no, we don't think that an increase in the tax on capital is going to boost investment output in the future. The question, again, I emphasize, is all else is not usually equal. If that money is used to reduce borrowing, then that reduction in borrowing has a positive effect on the economy.

Mr. RENACCI. My colleague earlier talked about revenues doubling over the next 10 years in your projection, and spending going up significantly. Do you have an idea how much spending is going to go up over the next 10 years?

Mr. ELMENDORF. I don't have that number calculated, Congressman. We think spending this year will be about $3.5 trillion, and in 2023, will be pushing $6 trillion. But I don't know the percentage change, I am afraid.

Mr. RENACCI. Okay. I yield back at this time.

Mr. PRICE. The gentleman yields back his time. The gentlelady from Wisconsin, Ms. Moore, for 5 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman, and thank you, Dr. Elmendorf, for appearing today. I have seen how you have done this very delicate dance all morning as Members have attempted to get you to agree with their approach about how to reduce the deficit, about how to grow the economy. What is more important? Is this tax policy better or worse? So I do appreciate your indulgence and your patience in this. But what I guess I learned and heard from you today, is that ultimately, we make the decisions around here about what happens, and that you know, it is, you know, all things are not equal.

So for example, the American Taxpayer Relief Act of 2012 the so-called fiscal cliff thing we did New Year's Day, it doubled the deficit, didn't it? It went from like $2.3 trillion to $4.6 trillion, and all, you know, and in that, I think we, for example, did not extend the payroll tax relief, and so therefore, we didn't help poor people there. We did things like make the unemployment insurance until December 31st of this year, whereas we increased the estate tax relief, went back to former law, made that permanent so that couples up to $10 million have an exemption.

So when we think about this provision, for example, in terms of long-term debt and the stimulative ability, or lack thereof, do you have an assessment of this particular—this particular policy with respect to long-term deficit reduction?

Mr. ELMENDORF. So Congresswoman, you actually understated the point. We thought deficits under current law had been $2.3 trillion over the decade, and the New Year's law added about $4.7 trillion to deficits over the decade, so it essentially tripled the deficits under current law. That change greatly increased government borrowing. It also reduced tax rates. Those two changes have opposing effects on future output. We haven't actually done a specific estimate of the economic effects of that law, but as I said before, the level of government borrowing has an important—negative higher borrowing has a bigger negative effect on future economic outcomes, and I think that——

Ms. MOORE. My time is waning, but I think that, you know, you have really made the point that all—that there are consequences of policy, and here this was an initiative, I think, that helped wealthier people more because the Bush era, Obama era, whatever people want to call it, tax rates, disproportionately helped richer people. Same thing with tax expenditures. We heard discussion here earlier about. And Greenspan calls them not tax expenditures, but tax entitlements. Isn't it, in fact, true that the tax expenditures almost equal the Medicare, and Medicaid, and the Social Security all together; that they almost equal that amount, and that they disproportionately go to wealthier people? I mean, 60 percent of our tax entitlements go to, you know, maybe 20 percent of the wealthiest people?

Mr. ELMENDORF. So Congresswoman, in our report last year we showed that tax expenditures through the individual income tax, and the payroll tax were larger than government spending on Social Security, larger than spending on defense, larger than spending on Medicare. The distribution varies a good deal across tax expenditures. Some of them benefit higher income people disproportionately, others are more focused on lower income people. We have some work underway.

Ms. MOORE. There is a lot of complaints, Dr. Elmendorf, about the 50 percent of people who don't pay any income tax, and so, I mean, the tax expenditure program for homeowners, and for charitable donations which are good tax expenditures, there is a lot of waste in it as well. I just want you to stipulate in your testimony here that, in fact, there is a lot of spending that is done through tax expenditure programs, and it increases the income disparity.

Mr. ELMENDORF. So I think, Congresswoman——

Ms. MOORE. Very regressive.

Mr. ELMENDORF. Many economists agree that tax expenditures are best thought of as government spending, even though they appear in the budget as——

Ms. MOORE. And are they regressive?

Mr. ELMENDORF. We have work underway on the distribution of tax expenditures, and it is not finished yet and I don't want to speak ahead of our not having completed that analysis.

Mr. PRICE. The gentlelady's time is expired.

Ms. MOORE. Thank you for your indulgence, Mr. Chairman.

Mr. PRICE. Thank you, the gentleman from Indiana, Mr. Messer, for 5 minutes.

Mr. MESSER. Mr. Chairman, I am the final questioner today.

Mr. PRICE. I think that is accurate and we appreciate you turning on your mic.

Mr. MESSER. Yeah, I was going to say, I have already eaten up my time without the mic. Thank you, Mr. Chairman, and thank you, Doctor. I just made the point I am the final questioner today. I appreciate that. Somebody gets to do it and today it is me. Doctor, I want to thank you for your eloquence. Thank you for your knowledge and wisdom and thank you for your stamina at today's committee hearing.

Mr. ELMENDORF. And yours, Congressman. You are one of the few people who actually sat through an entire hearing. And you too, Congressman.

Mr. MESSER. Well, you know, when you are new here you want to learn and I appreciate the knowledge that I have been able to gather today. I want to focus just for a second on a comment that you made earlier. I want to make sure that I have it accurate. You mentioned that by, was it 2023, we would have 40 percent more recipients of Medicare and Social Security than today?

Mr. ELMENDORF. Roughly yes, Congressman.

Mr. MESSER. You know, there is a lot of rhetorical energy spent around this building, appropriately so, making the point that we want to make sure we keep our commitments to those who have invested through a lifetime in Social Security and Medicare, certainly a commitment I intend to keep. I know of no one on either side of the aisle who believes any differently. If you saw that number and saw that we were going to increase by 40 percent by 2023, but you also knew that we were going to increase our workforce by 40 percent by 2023 so that you had the same number of taxpayers footing the bill for those benefits, or at least per recipient, then you wouldn't be nearly as alarmed by that number as you might be in a scenario that is far different. And so——

Mr. ELMENDORF. Yes.

Mr. MESSER. I was hoping that you could comment just a minute about maybe the historical trend of how many taxpayers we have had per recipient in those programs, and where we are going in that same trend.

Mr. ELMENDORF. Yes, Congressman. So we project that the labor force will grow much more slowly in the coming decade than it has grown in over the past several decades. And there are two main reasons for that: One is the retirement of the baby boom generation. They came into the labor force. They boosted the labor force growth, and as they retire, they will be holding it down. And the second is an end to the longstanding increase in women's labor force participation, which, again, pushed up the participation rate late in the late century, but has been pushing the other direction. But it has not been doing that now.

So the labor force growth will be a good deal slower going forward than it has been in the past. A lot of that is outside of the control of the Congress, but there are policies that Congress can enact or not that can have effects on labor force participation and policies on both the tax and spending sides of the budget.

Mr. MESSER. Yeah, and you know, I know you are probably reluctant to just throw out numbers that you may not have access to right in front of you, but could you talk just a little bit at least— if you have the numbers, great, but in the last 10, to 20, to 30 years how many workers per recipient did we have? What are the likely trends by 2023, for example?

Mr. ELMENDORF. I know that I have one fact, which is that a few years ago, 21 percent—a few years ago, the population age 65 or older was 21 percent of the population between ages 20 and 64. So 65 or older relative to those of working age, 20 to 64, that share was 21 percent a few years ago, and it will be 37 percent 25 years from now.

Mr. MESSER. Which would lead to, there will be fewer people paying for each recipient later?

Mr. ELMENDORF. Yes.

Mr. MESSER. If you can get those numbers to me, I would appreciate it. I would like to see whatever we are able to get track of.

Mr. ELMENDORF. Yes, Congressman. Yes.

Mr. MESSER. I just would want to make this very simple point, rightly so. A lot of energy is spent talking about the injustice that would fall to those who have invested and paid in over their lifetimes if they did not receive the benefits that they rightly should receive, but probably not enough energy is spent talking about the injustice to the next generation, those who will pay far more into a program that through which they may receive far less if nothing is done either. And so as we focus as a body on the importance of the justice of making sure that current recipients and those nearing retirement receive those benefits, I hope we spend equal energy thinking about the next generation and how we preserve these programs for them.

Mr. ELMENDORF. I would just say, Congressman, we produce a report every summer or fall on the Social Security program which lays out just the points you are making about the ratio of workers to beneficiaries, and about the effects of—the differential effects of the program on people born in different birth cohorts and at different points in the income distribution.

Mr. MESSER. I would love to see that.

Mr. PRICE. The gentleman yield back. I want to thank Director Elmendorf for being with us today, for his wisdom and his patience. I am charged with asking unanimous consent. The members have 7 calendar days to submit questions for the record, and without objection, so ordered. This hearing is adjourned.

Mr. ELMENDORF. Thank you, Congressman.

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

QUESTIONS SUBMITTED FOR THE RECORD BY CHAIRMAN RYAN

SENSITIVITY OF PROJECTED DEFICITS AND DEBT TO HIGHER-THAN-PROJECTED INTEREST RATES

Please provide how higher-than-expected interest rates would affect federal budget deficits and debt held by the public over the next decade. The three interest rate scenarios are as follows: 1) interest rates rise to their average levels over the 1991-2000 period, 2) interest rates rise to their average levels over the 1981-1990 period, and 3) interest rates follow a path that is consistent with the average of the 10 highest projections shown in the October 2012 and February 2013 releases of Blue Chip Economic Indicators. This is an update of an analysis that CBO did for Chairman Ryan on February 24, 2011.

ADDITIONAL INFORMATION ON THE IMPACT OF THE SEQUESTER

CBO has provided the Budget Committees with estimates of the impact from the automatic sequester on budget functions 050 (National Defense) and 570 (Medicare). The sequester's impact on non-defense accounts has been assigned to function 920 (Allowances), which is a non-specific classification used for programs and policies that are not easily classified into a more specific budget function. With publication of the OMB Report Pursuant to the Sequestration Transparency Act of 2012 (P.L. 112-155), information is now publically available on the impact of the sequester on an account-by-account basis. With this new information available, I am requesting that CBO provide an estimate of the non-defense sequester impact on a function-by-function basis in order to give the Budget Committee greater precision on understanding the impact of the sequester on non-defense budget functions.

PRIMARY BALANCE AND BUDGET SUSTAINABILITY

Based on CBO's recent budget outlook, if the fiscal year 2023 deficit was reduced to the level of net interest projected under the current law baseline, what is known as primary balance, would that stabilize the federal government's debt as a share of GDP and put its fiscal position on a sustainable path?

ADDITIONAL INFORMATION ON MACROECONOMIC FEEDBACK RESULTING FROM DEFICIT REDUCTION

CBO's report on Macroeconomic Effects of Alternative Budgetary Paths provides information on additional deficit impacts resulting from macroeconomic feedback under various budgetary paths. To better understand these results, I am requesting CBO to provide information on the revenue and outlay components of the "Effects on primary deficits" displayed in Table B-2 of the report.

QUESTIONS SUBMITTED FOR THE RECORD BY HON. LUKE MESSER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

As a member of the Committee on Education and the Workforce, and its Subcommittee on Higher Education and Workforce training, I am especially interested in slowing the rapidly rising cost of higher education. College costs too much. Parents are scrimping and saving and spending their nest eggs to pay for their children's education while trying to make ends meet in this sluggish economy.

Between 2001 and 2012, federal financial aid in constant dollars increased 140 percent. However, over the same period, published tuition and fees for in-state students at public four-year colleges increased by an average of 5.6 percent faster than the rate of inflation. In last year's State of the Union address, the President said "we can't just keep subsidizing skyrocketing tuition; we'll run out of money." Last night, the President said "taxpayers cannot continue to subsidize the soaring cost of higher education."

I am concerned that well-intentioned Federal education subsidies are hyper-inflating the cost of higher education, leading to more borrowing, higher interest payments, less disposable income, and slowed economic growth, essentially creating an "education bubble" not dissimilar to the housing bubble that nearly crippled the economy several years ago.

I have several questions on this topic for Dr. Elmendorf:

1. Do you believe the current rate of tuition inflation is driven in part by federal education subsidies?

2. Might rising college costs be constrained by more carefully targeting and measuring the effectiveness of federal education assistance?

3. What role has federal education assistance like Pell Grants played in subsidizing rising tuitions?

4. CBO's February baseline shows the Pell Grant program facing a funding cliff in Fiscal Year 2015 and annual shortfalls in subsequent years through the budget window. Do you believe the current structure of this important program is sustainable?

QUESTION SUBMITTED FOR THE RECORD BY MR. VAN HOLLEN

How do today's discretionary funding levels compare with pre-recession funding levels?

CBO'S RESPONSES TO QUESTIONS SUBMITTED FOR THE RECORD

RANKING MEMBER VAN HOLLEN

Question: How do today's discretionary funding levels compare with pre-recession funding levels?

Answer: With discretionary appropriations in 2013 based on H.R. 933 as passed by the House (including the effects of the sequestration in March) and on P.L. 113–2, the Disaster Relief Appropriations Act, 2013, total discretionary budget authority would be 5.4 percent higher this year than it was in fiscal year 2007 (the year before the recession officially began). Total annual discretionary budget authority increased by $57 billion over that period—from $1,070 billion in 2007 to an estimated $1,127 billion in 2013 (see the table below).

That difference is affected by a decline in funding for the wars in Iraq and Afghanistan and the substantial appropriations made in 2013 in response to Hurricane Sandy (funding in 2007 included some funding in response to Hurricane

Katrina and other hurricanes). War-related funding dropped from $170 billion for 2007 to $92 billion (including the effects of sequestration) for 2013, a reduction of $78 billion. However, the funding for 2013 related to hurricane relief and recovery was $40 billion higher than the amount provided for similar activities in 2007.

Excluding appropriations for those purposes, discretionary budget authority rose from $892 billion in 2007 to $987 in 2013, an increase of about 11 percent. During that period, prices (as measured by the consumer price index for urban consumers) rose by 13 percent, and nominal gross domestic product (GDP) increased by 16 percent. As a result, discretionary appropriations—based on the House-passed appropriations for 2013 and excluding funding for overseas contingency operations and hurricane relief—declined by 2.2 percent in real (inflation-adjusted) terms between 2007 and 2013 and dropped from 6.4 percent of GDP to 6.2 percent of GDP over that period.

DISCRETIONARY BUDGET AUTHORITY IN FISCAL YEARS 2007 AND 2013

	Billions of dollars		Percentage change
	Actual 2007	Estimated 2013	
War-Related Funding	170	92	−46.0
Hurricane Relief Funding	7	48	545.5
Other Funding	892	987	10.7
Total	1,070	1,127	5.4

CHAIRMAN RYAN

Question 1: Sensitivity of Projected Deficits and Debt to Higher-than-Projected Interest Rates—Please provide how higher-than-expected interest rates would affect federal budget deficits and debt held by the public over the next decade. The three interest rate scenarios are as follows: 1) interest rates rise to their average levels over the 1991–2000 period, 2) interest rates rise to their average levels over the 1981–1990 period, and 3) interest rates follow a path that is consistent with the average of the 10 highest projections shown in the October 2012 and February 2013 releases of Blue Chip Economic Indicators. This is an update of an analysis that CBO did for Chairman Ryan on February 24, 2011.

Answer: To estimate the effect that higher interest rates would have on the budget, CBO has updated the analysis it did in February 2011 (that earlier analysis is available on CBO's website at www.cbo.gov/publication/22039).

For scenarios 1 and 2, we have assumed that by 2017, interest rates would rise to and then remain at the levels that Treasury interest rates averaged during the 1990s (scenario 1) or 1980s (scenario 2). Thus, over the 2018—2023 period, rates for 3-month Treasury bills would be 4.9 percent under scenario 1 and 8.8 percent under scenario 2, compared with 4.0 percent in CBO's baseline projections (see Table 1 below). Similarly, rates on 10-year Treasury notes would average 6.7 percent between 2018 and 2023 under scenario 1 and 10.6 percent under scenario 2, compared with 5.2 percent in the baseline projections.

For scenario 3, we have based the assumed path of rates on the average of the 10 highest forecasts from the Blue Chip Economic Indicators: Rates for 2013 and 2014 come from the February 2013 Blue Chip report, and rates for 2015 through 2023 come from the October 2012 Blue Chip report (the most recent report with longer-term projections). Following the procedure used in our 2011 analysis, we have adjusted the Blue Chip forecast upward by 30 basis points to account for significant interest rate movements since that report was released. Under that scenario, interest rates for 3-month Treasury bills would be much higher from 2015 through 2017 than in CBO's baseline projections and would be 4.5 percent from 2018 through 2023, compared with 4.0 percent in the baseline projections.

The budgetary effects of those alternative interest rate paths would be minimal in 2013 but substantial over the coming decade. Relative to CBO's baseline projections, interest payments between 2014 and 2023 would be $1.4 trillion higher under scenario 1, $6.3 trillion higher under scenario 2, and $1.1 trillion higher under scenario 3 (see Table 2 below). Cumulative deficits and debt held by the public at the end of the 2014—2023 period would be higher by similar amounts.

CBO strives to create baseline budget and economic projections that are in the middle of the distribution of possible outcomes. As a consequence, CBO sees an equal risk of interest rates' being higher or lower than in its baseline projection.

Lower interest rates would imply lower federal interest payments, and the budgetary effects of differences in interest rates relative to CBO's baseline would be roughly symmetric.

It is important to note that the estimates in Table 2 do not account for the effects on the federal budget of other differences in economic conditions that would probably accompany higher interest rates. For example, interest rates could be higher than in CBO's baseline because inflation could be higher than CBO anticipates. Indeed, inflation was higher during the 1990s, and much higher during the 1980s, than CBO projects for the next decade: Inflation as measured by the consumer price index averaged 5.1 percent annually during the 1980s and is projected by CBO to average 2.2 percent over the coming decade. If CBO assumed that inflation over the next decade matched the average seen during the 1980s, to parallel the assumption about interest rates, projected tax revenues would be much higher than in CBO's baseline projections, and federal spending would be moderately higher. On balance, those two effects would reduce deficits.

Not only was inflation higher in the 1980s and 1990s than is currently projected for the next decade, real interest rates (nominal rates adjusted for inflation) were also higher during those periods than in CBO's baseline projections for the coming decade. If real interest rates over the next decade ended up matching those historical values, it might be because the economy (and thus demand for credit) was stronger than in CBO's projections. In that case, revenues would be greater than the amounts projected in the baseline, offsetting some of the increase in interest costs.

The causes of higher interest rates would also affect the conduct of monetary policy by the Federal Reserve. Changes in both interest rates and the magnitude of the Federal Reserve's purchases and sales of securities would affect remittances by the Federal Reserve to the Treasury (which are counted in the budget as revenues). Without knowing what overall economic conditions would be under those three scenarios, and thus what actions the Federal Reserve would take, it is not possible to estimate how the Federal Reserve's remittances to the Treasury might differ from the amounts in CBO's baseline projections.

TABLE 1.—CBO'S ESTIMATE OF THE TREASURY INTEREST RATE SCENARIOS REQUESTED BY CONGRESSMAN RYAN

[Percent, by fiscal year]

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Rates on 3-Month Bills											
CBO's Baseline	0.1	0.1	0.2	1.0	2.9	4.0	4.0	4.0	4.0	4.0	4.0
Scenario 1	0.1	0.1	0.2	1.7	4.0	4.9	4.9	4.9	4.9	4.9	4.9
Scenario 2	0.1	0.1	0.4	3.6	7.4	8.8	8.8	8.8	8.8	8.8	8.8
Scenario 3	0.2	0.4	2.6	4.0	4.4	4.5	4.5	4.5	4.5	4.5	4.5
Rates on 10-Year Notes											
CBO's Baseline	1.9	2.5	3.2	4.1	4.9	5.2	5.2	5.2	5.2	5.2	5.2
Scenario 1	2.2	3.4	4.5	5.5	6.4	6.7	6.7	6.7	6.7	6.7	6.7
Scenario 2	2.7	4.7	6.7	8.6	10.1	10.6	10.6	10.6	10.6	10.6	10.6
Scenario 3	2.2	2.9	4.7	5.6	5.7	5.7	5.8	5.8	5.8	5.8	5.8

Source: Congressional Budget Office.

Note: Scenarios 1, 2, and 3 were specified by Congressman Ryan as alternatives to CBO's baseline projections.

TABLE 2.—EFFECT ON THE DEFICIT OF INTEREST RATE SCENARIOS REQUESTED BY CONGRESSMAN RYAN RELATIVE TO CBO'S FEBRUARY 2013 BASELINE

[Billions of dollars, by fiscal year]

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total, 2014–2018	Total, 2014–2023
Scenario 1	2	13	32	66	104	136	162	190	218	246	274	352	1,443
Scenario 2	4	33	85	201	355	529	671	833	103	1,185	1,378	1,204	6,274
Scenario 3	3	11	55	126	138	122	120	129	137	147	157	453	1,143

Source: Congressional Budget Office.

Note: Scenarios 1, 2, and 3 were specified by Congressman Ryan as alternatives to CBO's baseline projections.

Question 2: Additional Information on the Impact of the Sequester—CBO has provided the Budget Committees with estimates of the impact from the automatic sequester on budget functions 050 (National Defense) and 570 (Medicare). The sequester's impact on non-defense accounts has been assigned to function 920 (Allowances), which is a non-specific classification used for programs and policies that are not easily classified into a more specific budget function. With publication of the OMB Report Pursuant to the Sequestration Transparency Act of 2012 (P.L. 112–155), information is now publically available on the impact of the sequester on an account-by-account basis. With this new information available, I am requesting that CBO provide an estimate of the non-defense sequester impact on a function-by-function basis in order to give the Budget Committee greater precision on understanding the impact of the sequester on non-defense budget functions.

Answer: The best information to answer this question is contained in backup data for the Office of Management and Budget's OMB Report to the Congress on the Joint Committee Sequestration for Fiscal Year 2013 (March 1, 2013). Those data are not yet available. CBO will provide you with these functional breakdowns when the data become available.

Question 3: Primary Balance and Budget Sustainability—Based on CBO's recent budget outlook, if the fiscal year 2023 deficit was reduced to the level of net interest projected under the current law baseline, what is known as primary balance, would that stabilize the federal government's debt as a share of GDP and put its fiscal position on a sustainable path?

Answer: Assuming primary budget balance in 2023 would lower CBO's deficit projection for that year from $978 billion to $857 billion, or 3.3 percent of GDP (all else being equal). However, that is not enough information to know whether the federal government's debt as a share of GDP would be stable in that year. That answer would depend on the ratio of debt to GDP in the previous year, and on output and interest rates in 2023, which in turn would depend on the path of deficits in prior years.

Question 4: Additional Information on Macroeconomic Feedback Resulting from Deficit Reduction—CBO's report on Macroeconomic Effects of Alternative Budgetary Paths provides information on additional deficit impacts resulting from macroeconomic feedback under various budgetary paths. To better understand these results, I am requesting CBO to provide information on the revenue and outlay components of the "Effects on primary deficits" displayed in Table B–2 of the report.

Answer: Those revenue and outlay components are shown in the table below. The amounts in the table represent only the macroeconomic feedbacks; the underlying changes in revenues and outlays that produced different paths for the deficit, and thus different macroeconomic conditions, were not specified in the report.

The estimated macroeconomic feedback effects on primary deficits consist largely of changes in revenues; the estimated changes in primary outlays are relatively small. Changes in the amount of interest paid on federal debt held by the public are similar in magnitude to the changes in revenues.

CBO estimated the additional deficit impacts resulting from macroeconomic feedbacks for that report using a simplified analysis that took into account changes in taxable income and interest rates, among other factors. That analysis did not incorporate a detailed program-by-program analysis, as do CBO's regular budget projections.

BUDGETARY IMPACT OF ECONOMIC EFFECTS OF ILLUSTRATIVE PATHS, FISCAL YEARS 2014 TO 2023, RELATIVE TO PROJECTIONS UNDER CURRENT LAW

[Billions of dollars]

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total, 2014–2023
Increases (−) / Decreases (+) in Deficits											
$2 Trillion Increase in Primary Deficits											
Effect on primary deficits											
Revenues	7	11	7	2	−5	−9	−13	−18	−23	−28	−70
Noninterest spending	*	−1	*	*	1	2	1	*	*	*	3
Net effect on primary deficits	7	12	8	2	−6	−11	−14	−18	−23	−28	−71
Debt service	*	−1	−3	−5	−5	−6	−9	−12	−16	−22	−79

BUDGETARY IMPACT OF ECONOMIC EFFECTS OF ILLUSTRATIVE PATHS, FISCAL YEARS 2014 TO 2023, RELATIVE TO PROJECTIONS UNDER CURRENT LAW—Continued

[Billions of dollars]

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total, 2014–2023
Effect on Total Deficits	7	11	5	−3	−11	−17	−23	−30	−39	−50	−151
$2 Trillion Reduction in Primary Deficits											
Effect on primary deficits											
Revenues	−7	−11	−11	−4	4	9	13	17	22	28	61
Noninterest spending	*	1	2	1	*	1	2	2	2	2	13
Net effect on primary deficits	−7	−12	−12	−5	3	8	12	16	20	26	47
Debt service	*	*	1	2	3	4	6	9	13	17	57
Effect on Total Deficits	−7	−12	−11	−3	6	12	18	25	33	43	103
$4 Trillion Reduction in Primary Deficits											
Effect on primary deficits											
Revenues	−14	−23	−23	−13	7	18	26	34	44	55	112
Noninterest spending	*	2	3	2	*	1	2	2	3	4	19
Net effect on primary deficits	−15	−25	−26	−15	6	17	24	32	41	52	92
Debt service	*	2	2	2	3	6	10	16	22	30	94
Effect on Total Deficits	−14	−24	−24	−13	9	23	35	48	63	82	186

Source: Congressional Budget Office.

Notes: The illustrative paths are described in detail in Congressional Budget Office, Macroeconomic Effects of Alternative Budgetary Paths (February 2013), at the beginning of the section "Budget Deficits Under Three Illustrative Paths."

The primary deficit equals revenues minus noninterest spending. Debt service is the change in the deficit that would result from changes in the amount of interest paid on the public debt (including the effects of changes in interest rates). The effect on total deficits is the sum of the effect on primary deficits and debt service.

Negative numbers indicate that deficits under the path are larger than those under CBO's baseline, which incorporates an assumption that current laws generally remain unchanged; positive amounts indicate that deficits are smaller.

* = between −1 and 1.

CONGRESSMAN MESSER

Question 1: Do you believe the current rate of tuition inflation is driven in part by federal education subsidies?

Answer: CBO has not studied the extent to which federal education subsidies affect tuition inflation. In fiscal year 2012, the federal government provided about $106 billion in direct student loans, $33 billion for Pell grants, and $9 billion for education benefits for veterans. That federal assistance probably has contributed to increases in listed tuition rates, at least in some cases. The potential for federal subsidies to contribute to higher tuition rates probably depends on the share of students receiving aid at different types of educational institutions—such as public, private nonprofit, and for-profit schools—as well as the institutions' financial objectives and constraints. For-profit schools have the largest share of students receiving federal subsidies (64 percent in 2007—2008), and one study found that for-profit schools where students can use federal aid charge tuition 75 percent higher than similar schools where they cannot use federal grants.[1] However, some unknown portion of that 75 percent difference may represent higher costs that schools incur to meet the Department of Education's requirements for participation in federal student financial aid programs.

Question 2: Might rising college costs be constrained by more carefully targeting and measuring the effectiveness of federal education assistance?

Answer: To the extent that federal aid has an effect on tuition rates, reducing the amount of such aid could reduce the effect. If the same total volume of aid was targeted so that more of it went to students who would not otherwise attend college, it would be more effective in stimulating demand for postsecondary education but, as a result, would tend to increase any effect on tuition rates. CBO does not expect

[1] Stephanie Reigg Cellini and Claudia Goldin, Does Federal Student Aid Raise Tuition? New Evidence on For-Profit Colleges, Working Paper 17827 (National Bureau of Economic Research, February 2012), www.nber.org/papers/w17827.

that increased monitoring or measurement of the effectiveness of federal assistance would have a significant impact on tuition rates.

Question 3: What role has federal education assistance like Pell Grants played in subsidizing rising tuitions?

Answer: CBO has not studied the effect that Pell grants or other federal aid has had on rising tuition. However, there is some evidence that federal assistance has been a factor in tuition rates at for-profit schools. The evidence for an impact of federal subsidies on tuition rates listed by other types of institutions is weaker, perhaps in part because such subsidies make up much lower shares of their total revenues. Data from a recent study of the Pell Grant program indicate that the grants account for 14 percent of revenues at for-profit schools eligible to distribute federal aid, 7 percent at nonselective public schools, 4 percent at nonselective nonprofit private schools, 2 percent at selective public schools, and 1 percent at selective private schools.[2]

A related question is the impact of federal education subsidies on the "net tuition" rates students face after subtracting their schools' own financial aid from the listed tuition rates. The study on Pell grants estimated that institutions capture 16 percent of the value of the grants by reducing their own aid to recipients.[3] However, the estimated capture rates varied widely, from essentially zero for public institutions to close to 80 percent for selective private schools.

Question 4: CBO's February baseline shows the Pell Grant program facing a funding cliff in fiscal year 2015 and annual shortfalls in subsequent years through the budget window. Do you believe the current structure of this important program is sustainable?

Answer: Under current law, funding for the Pell Grant program comes from both discretionary and mandatory sources. In 2009, the Congress began supplementing the discretionary portion of the program with funding provided outside the regular appropriation process. The combination of supplemental funds and the budget authority provided in the regular appropriation process allowed the discretionary portion of the program to support a maximum award level of $4,860. In the future, maintaining the award level at $4,860 would require either large increases in the regular appropriations (which would have to be accommodated under the annual caps on discretionary spending enacted as part of the Budget Control Act of 2011) or significant additional supplemental funding.

[Whereupon, at 12:44 p.m., the committee was adjourned.]

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[2] Lesley J. Turner, "The Incidence of Student Financial Aid: Evidence from the Pell Grant Program" (draft, Department of Economics, Columbia University, April 2012), www.columbia.edu/?ljt2110/LTurner—JMP.pdf (1 MB).
[3] Ibid.