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HEARING ON THE HISTORY AND DRIVERS OF OUR NATION'S DEBT AND
ITS THREATS

Tuesday, September 13, 2011

United States Congress

Joint Select Committee on Deficit Reduction

Washington, D.C.

The committee met, pursuant to call, at 10:33 a.m., in Room SH-216, Hart Senate Office Building, Hon. Patty Murray [co-chairman of the committee] presiding.

Present: Senator Murray, Representative Hensarling, Senator Baucus, Representative Becerra, Representative Camp, Representative Clyburn, Senator Kerry, Senator Kyl, Senator Portman, Senator Toomey, Representative Upton, and Representative Van Hollen.

Co-Chair Murray. Good morning. This hearing of the Joint Select Committee on Deficit Reduction will come to order.

As my co-chair, Representative Hensarling, mentioned at our meeting on Thursday, we have agreed to alternate chairing these hearings, with him chairing the hearings that are held on the House side, and I will be doing the ones here in the Senate.

I want to recognize and thank all of our fellow committee members for being here today, as well as our witness, Dr. Elmendorf, for joining us today.

And I want to thank all the members of the public who are here today as well. We appreciate your presence and ask that you help us maintain decorum by refraining from any displays of approval or disapproval during this hearing.

Before I start, I do want to announce that the joint select committee's Web site is now up and running. Members of the public can go to www.deficitreduction.gov, where they can provide us input and ideas to this committee and where all public hearings will be streamed live, starting today.

Today, we are going to start off with brief opening statements from committee members -- 15 minutes for

Democrats and 15 minutes from the Republican side. We will then hear from Dr. Elmendorf. And following his testimony, we will have some time for questions and answers.

The topic of today's hearing is "The History and Drivers of Our Nation's Debt and Its Threats." I think this is a fitting opening for us for the difficult work this committee has ahead of us. We are tasked with tackling a problem that wasn't created overnight and that didn't come about just in the last few years.

Our debt and deficit problems have a lengthy and complex history, and we will not be able to truly address them without a deep and honest understanding of the policies and circumstances that have led us to where we are today.

The challenges that we face are real, and our task will not be easy. But I am confident we can get it done because we have done it before.

Like a number of my fellow committee members, I was here back in the '90s, when we were facing serious deficits and a mounting public debt. I was proud to work with President Clinton and Republicans in Congress to balance the budget in a way that truly worked for the American people, a way that made smart cuts to Government spending that were

desperately needed, included revenues, and continued to make the strong investments in healthcare, education, and infrastructure that helped lay down a strong foundation for economic growth.

The balanced and bipartisan work we did not only balanced the budget and it not only helped set our country up to create millions of new jobs, but it also put us on track to completely pay down our debt by 2012, which was a great accomplishment.

But as we all know, a lot has changed since then. For many reasons, our deficit and debt have exploded in the years since. Some of these reasons have to do with Government policies here at home, some with decisions made regarding our policies overseas, and others due to the financial and economic crisis that has devastated families and businesses here over the last few years.

I am looking forward to hearing more about the scope and drivers of our deficit and debt from Dr. Elmendorf today. And I am confident the members of this committee can help bring our Nation together once again around a balanced and bipartisan path to fiscal health and economic growth.

With that, I will call on my co-chair, Mr. Hensarling,

for his opening statement.

Co-Chair Hensarling. Thank you, Madam Co-Chair.

The purpose of today's hearing is to really highlight the unsustainable nature of our Nation's debt. And I believe the term "unsustainable," frankly, is understated.

I certainly want to welcome Dr. Doug Elmendorf, head of the CBO, who, when I was a member of the Budget Committee, I have had an opportunity to work with, truly a professional in this town. Sir, I look forward to your testimony.

In the last organizational meeting we had, I mentioned the work by Professors Carmen Reinhart and Kenneth Rogoff, "This Time Is Different." Through their historical study of financial crisis, they indicated that letting debt rise above 90 percent of GDP was, frankly, a recipe for bad things to happen to a nation.

Well, this year, our Nation has raced past that tipping point. Our gross debt has now surpassed 100 percent of GDP. And I believe there are two crises in our Nation -- not just the debt crisis, but the jobs crisis -- and they are clearly connected. The explosive growth in our Nation's debt hampers our job creation today.

Last week, I quoted a small business person from the 5th District of Texas on the subject. Today, I want to quote from a few more, names you may be more familiar with.

Bernie Marcus, former chairman and CEO of Home Depot, which employs 255,000. "If we continue this kind of policy, we are dead in the water. If we don't lower spending and if we don't deal with paying down the debt, we are going to have to raise taxes. Even brain dead economists understand that when you raise taxes, you cost jobs."

Mike Jackson, CEO, AutoNation, 19,000 employees. "The best thing that this town could do to help this economic recovery become sustainable is to deal with the deficit and to see tax reform."

Jay Fishman, chairman and CEO of Travelers Insurance Company. "What is really weighing on their minds is not knowing how the coming explosion in Federal debt is going to affect their borrowing costs, liquidity, cost of doing business, and prices."

Finally, 2 or 3 months ago, the U.S. Chamber came out with a survey, their small business survey, 83 percent of respondents said that America's debt and deficit have a negative impact on their business.

So I would make the point, Madam Co-Chair, that a path to credible deficit reduction is a jobs program, and we should not be deterred in that mission. We have a spending-driven debt crisis. The deficit reduction will be a jobs plan.

And I look forward again to hearing the comments of our colleagues as we go about this important work and of the testimony of Dr. Elmendorf. And I yield back.

Thank you.

Co-Chair Murray. We will now turn to our members, beginning with Representative Becerra.

Mr. Becerra. I thank the two co-chairs and thank Dr. Elmendorf for being with us.

The creation of this Joint Select Committee on Deficit Reduction is the direct result of legislative policies and economic recessions that have hit us over the last 10 years and that have caused the Congressional Budget Office's 10-year estimated \$5.6 trillion surplus in 2001 to turn into a more than \$6 trillion deficit that we see today. So to know where to go with the work that we have to do, you have to know from where we came.

Today, we will hear about how we lost our way. What

we will hear is that a select few in this country enjoyed the additional Government spending that occurred in those 10 years while the rest of Americans are being confronted with paying the tab.

In January 2001, CBO's assessment in its yearly Budget and Economic Outlook report was this, "The outlook for the Federal budget over the next decade continues to be bright. Assuming that current tax and spending policies are maintained, CBO projects that the mounting Federal revenues will continue to produce growing budget surpluses for the next 10 years."

But as we all know, current tax and spending policies were not maintained. Dr. Elmendorf, it is exactly these policies that induced the Federal deficit, which I want to explore in my questioning with you today.

Decisions were made to extinguish a \$5.6 trillion surplus. The individual and groups who received the most benefits should be willing and ready to ante up, to meet their patriotic duty to contribute revenues and necessary spending decisions to heal this country's long-term fiscal situation.

We need to ask ourselves was it the senior citizen,

the student, or the Wall Street banker who received the benefit of this spending binge? When we have our answer, we should ask the appropriate person or group to pay their fair share to right the wrong of running up the Government's debt.

I look forward to working with my colleagues to take the responsibility of improving job creation in this country and fixing the long-term deficits that we face by ensuring that those responsible for our deficits pay their fair share.

And with that, I yield back the balance of my time.

Co-Chair Murray. Thank you very much.

Senator Kyl?

Senator Kyl. Thank you, Madam Chairman.

And welcome, Mr. Elmendorf.

The subject of the hearing today is "The History and Drivers of the Nation's Debt and Its Threats." Obviously, you need to know what the problem is before you can develop solutions.

One of the things we will hear is that entitlement spending is a key driver of our debt. And I think there is a consensus about that on both sides of the aisle. The

concern I have is that some people fear that that means that the solution has to be a cut in benefits or a cut in payments to providers for programs like Medicare and Medicaid, for example, and I would like to focus very specifically on a potential alternative to that.

There may be very substantial savings that can be obtained from administrative efficiencies that would not involve cuts in these programs. That is one of the things that I will be talking to Dr. Elmendorf about today.

We hear a lot of talk about waste, fraud, and abuse. It is a trite phrase, but the reality is there is a significant amount of truth to it. And I think, especially with regard to Medicare and Medicaid, we have got to find ways to achieve these administrative savings.

Let me just quote from one of the experts from Cato Institute, Mike Cannon. In a Forbes blog less than 2 months ago, he says, "Judging by official estimates, Medicare and Medicaid lose at least \$87 billion per year to fraudulent and otherwise improper payments, and about 10.5 percent of Medicare spending and 8.4 percent of Medicaid spending was improper in 2009."

Others, like Harvard fraud expert Malcolm Sparrow, say

actually that is low. He said loss rates due to fraud and abuse could be 10, 20, maybe even 30 percent in some segments.

Obviously, this is an important subject to address. And in order to do that, we may have to spend a little bit more money on the front end for people who can review the claims that are filed and so on, in order to make sure that they don't pay improper claims.

But at the end of the day, one of the reasons we haven't attacked this problem is that the CBO has had a very difficult time in scoring potential savings based upon potential approaches to the problem. And what I want to explore with Dr. Elmendorf today is how CBO can help our committee find ways to achieve administrative efficiencies, saving a lot of the money that we should not be spending, so that we do have the money to spend on the beneficiaries and the providers of important programs like Medicare and Medicaid.

Madam Chairman, Mr. Chairman, thank you.

Co-Chair Murray. Senator Baucus?

Senator Baucus. Thank you, Senator Murray.

I want to begin just by echoing what Senator Kyl said.

I think there is a lot of fraud and waste in the Medicare and Medicaid, which we don't properly attack, and much of that is due to scoring requirements that we have to adhere to. And I would hope that we could somehow create a way to get beyond that. It is an excellent point, and I am glad that he made it.

One of our Founding Fathers, Patrick Henry, once said, "I know of no way of judging the future, but by the past." And today, we examine the past for lessons to improve our economic future -- to reduce the deficit, create jobs, and create the certainty our country needs to thrive in the global economy.

The world is watching us. They are watching us closely. They are watching what we do and the next steps that we take as a country to confront our deficits. We can do this. We have already begun the process by cutting \$900 billion. We have already done it. We have taken a first step.

And while the road ahead will not be easy, we have a duty, I think, to think even bigger, aim higher, ensure our country is on sound fiscal footing for the long term. We have a duty, I think, to ensure that we approach these cuts

in a balanced way that creates jobs.

When I was home in Montana again last weekend, I heard over and over again, people said, "Max, let's get it done. Appreciate you being on that committee. Get it done. We need our country to get it done."

I know every member of this panel hears the same comments from their constituents when they are home, just as every Member of Congress does. And I urge us to listen to the wishes of our employers.

We are just the hired hands. We are just the employees. The people that we work for, the people that elect us or unelect us want us to get this done in a balanced, fair way.

Today, we review the sources of our problem. It is obvious that the factors that created our current deficit are the cost of two wars; long-term healthcare costs, which we began to tackle in health reform; a stagnant economy, which increased spending; and reduced Federal revenues, which are at historic lows.

Today, Federal revenues make up about 15 percent of GDP, compared to, for example, about 17 to 19 percent during the Reagan administration. A combination of factors created

the deficit. It will take a combination of factors to resolve it. There is no silver bullet. So let's get together and get our work done.

Co-Chair Murray. Thank you very much.

Representative Upton?

Mr. Upton. Well, thank you, Madam Chair.

And I intend to be brief. Chris Van Hollen reminded us last week that we had 77 days to get this thing done. That means we have got about 72 days now, and we are going to leave some extra days, hopefully, for you, Dr. Elmendorf, to have your green eyeshade guys and women be able to put this package together for us to reach the goal.

Last week, I sat with Chairman Camp and Chairman Baucus -- and Chairman Baucus, again, my folks in Michigan this last weekend assured me that they are rooting for us as well to get a solution to the problem that they all really do understand. And I know the three of us were on our feet when the President talked about entitlement reform, specifically Medicare and Medicaid. And I must say that I was disappointed that I did not see the President's written proposal come up like he did some others yesterday.

So I just want to say I am looking forward to working

with all my colleagues here. I am going to submit my full statement for the record so that we can go back, so that we, in fact, all can go to work to get this thing done.

I yield back.

[The statement of Mr. Upton follows:]

Co-Chair Murray. Thank you very much.

Representative Clyburn?

Mr. Clyburn. Thank you very much, Madam Chair, Mr. Chairman.

Dr. Elmendorf, thank you for taking the time to talk with us today.

I think it is appropriate that today's hearing is entitled, "The History and Drivers of Our Nation's Debt and Its Threats." If we want to solve the related problems of debt and joblessness, we need to know how these problems arose. In 2000, we had a \$236 billion surplus and had begun paying down our national debt. The economy was booming for all Americans, unemployment was at 4 percent, and the poverty rate dipped to its lowest level since 1979.

Instead of building on the policies that have served us so well, we embarked upon two wars, one of which was dubious at best. Using credit cards, we instituted two tax cuts, totaling \$544 billion, which were tilted in favor of millionaires and billionaires. We created a new prescription drug benefit program, which CBO estimates will cost \$967 billion over the next 10 years, and allowed mortgage lenders to gamble away the economic prosperity of

millions of American families.

And then it was declared that deficits don't matter. This special committee was created because deficits and debt do matter. Now we find ourselves with painfully slow growth, unacceptably high unemployment, deficits as far as our eye can see, and a mounting long-term debt burden.

As we work together to achieve significant deficit reduction, it is important for us to remember how we got here. Many factors got us into this situation, and many factors are needed to get us out.

We must balance the budget with a balanced approach that includes job creation, revenue increases, and smart spending cuts. Shared sacrifice will be required. We cannot solve the problem on the backs of the most vulnerable in our society who did nothing to cause the problem.

I am willing to make tough compromises. I have said that if the distance between an opponent and me is five steps, I am willing to take three, as long as the opponent takes the other two.

Dr. Elmendorf, thank you again for being here, and I look forward to discussing these issues with you in the Q&A period.

Thank you, and I yield back.

Co-Chair Murray. Senator Portman?

Senator Portman. Thank you, Madam Chair.

And welcome to Director Elmendorf. As you all know, this committee is going to be relying heavily on you for your analysis and for your scoring. And to you and your colleagues behind you, I thank you in advance for the many hours that you will put in. Our success or failure will depend in large measure on your good work. So we need you and look forward to your responses to our many requests.

I listen to my colleagues' comments this morning, and I must say I am delighted that you are here today because we need to have a little objective analysis of how we got to where we are, and I know you will provide that. I hope you will also talk about the appropriate baseline for us to use to examine our proposals.

When measuring new proposals, the baseline questions help us determine "compared to what," -- whether it is a spending issue or revenue issue. And as you know, I have some concerns about the current law baseline because I don't think it is realistic. And I want you to address that today, if you could. Is the current-law or current-policy

baseline more realistic? Or is there another one like the long-term extended baseline, alternative fiscal scenario? All these questions matter greatly in our work.

We have a \$1.5 trillion task over the next 10 years. This, of course, is a huge challenge. But I would also like your analysis of how that compares to the real fiscal challenge over the next 10 years and the real economic challenge we face.

As many of the colleagues on the committee have mentioned this morning, our economy is directly linked to what we do. And we will hear about this today from you. We will see how we got in this situation we are in largely because of economic conditions -- Just as in the late '90s when a growing economy helped bring a unified balanced budget faster than anybody expected.

Using your data and the current policy baseline, as I look at \$1.5 trillion, I think it is about 4 percent of projected spending over the next 10 years. So, in that sense, \$1.5 trillion seems realistic. It is also, as I look at it, based on, again, your data and the current policies, less than 20 percent of the projected increase in the deficit over the next 10 years.

So \$1.5 trillion seems to me to be something we should be doing at the very least. Again, I look forward to your insights on that and what is the most realistic baseline.

I hope you and your colleagues will also help us better understand the impacts of policy choices over the coming decades. As I look at your projections, it seems to me that deficit and debt levels would be devastating to our economy over the second, third, and fourth 10 years if we don't do something about the longer-term impact.

So while we could within this budget window find ways to get to \$1.5 trillion, it will not be something that markets will react to well, in my view, unless we also are looking at long-term impacts. I would love to have your view there.

The long-term budget estimates are so unsustainable that your alternative budget scenario simply stops calculating the national debt after 2036 because it is so unsustainable. We will have crossed into totally uncharted territory.

Clearly, entitlement spending is driving those long-term deficits to impossible levels. I am interested in hearing what reforms you think can protect those in need,

which we must do, while at the same time modernizing these programs and placing them on a sustainable path for future generations.

Again, thank you for being before us. And more importantly, thank you for all the hard work you will be doing with us over the next several weeks.

Co-Chair Murray. Thank you.

Senator Kerry?

Senator Kerry. Madam Chairwoman, thank you.

We all agree that we are facing an unsustainable financial future, and under the CBO's alternative fiscal scenario, the debt is going to reach 82 percent of GDP by 2021. That is higher than any year since 1948, and we all agree we can't let that happen.

But to avoid that dismal scenario, we are going to have to be pretty clear-eyed about the way that we got here and the forces that keep us on this dangerous trajectory. I think it is factual to say that this road began now more than a decade ago. Some would argue even longer.

But you have economic meltdown, two wars, rounds of the largest tax cuts in history that did not produce the jobs that were predicted, and then efforts to forestall

larger economic collapse more recently. All of these contributed.

Demographic challenges loom large in the outyears, and it is more than just a spending problem, narrowly defined. And I think we do the dialogue a disservice by oversimplifying it because if it was a mere spending issue, it would be a lot easier to solve. But also because many tax expenditures are a form of spending in disguise.

Now while there may be partisan interpretations of how we got here, there is a bipartisan consensus not just about the urgency of action to dig us out of this mess, but about the approach that it requires. When I say bipartisan, three bipartisan groups that looked at the problem in recent months -- Rivlin-Domenici, Simpson-Bowles, and the so-called Gang of Six -- have all said -- all, unanimously -- that any real solution needs to be balanced with a mix of revenues and spending cuts and long-term reforms.

Now we benefit from their guideposts, and we also benefit from the cautionary lessons, important cautionary lessons of other countries. That means not fixating on austerity measures alone, particularly in the short term.

We have seen the damage that they have caused across

Europe, and we can't put our own fragile economy in jeopardy by taking actions that will slow economic growth and decrease job creation. We need growth, not just revenue and not just cuts. And any economist worth their salt, any business person in America today will tell us creating jobs today helps reduce the deficit tomorrow.

Last week, the Committee for a Responsible Budget, a bipartisan organization including some of our country's leading experts on budget issues, including the co-chairs of the fiscal commission, recommended that this committee go big, go long, and go smart. I think Director Elmendorf's testimony today helps solidify the reality that we need to go big and reap savings of more than \$1.5 trillion to address long-term deficits. We need to go long and address our long-term budget issues. And most importantly, we need to go smart and address the budget without preconceived dogmas or political agendas.

So I look forward to delving into these issues today with you, Dr. Elmendorf, and thank you for coming here to help us shape fair, balanced, thoughtful recommendations for this committee.

Co-Chair Murray. Representative Camp?

Mr. Camp. Thank you, Madam Chair.

There has been a lot of important things already said this morning. Our time is short today. Both in the committee and as Mr. Upton pointed out, our time is short in terms of trying to meet the responsibilities we have been given under the Budget Control Act.

So I look forward to hearing from Mr. Elmendorf. I think it is important that we just get down to business. So I will yield back the balance of my time.

Co-Chair Murray. Thank you.

Representative Van Hollen?

Mr. Van Hollen. Thank you, Madam Chairman.

Yesterday, there were two important developments that relate to our work. First, the President submitted to the Congress a jobs plan that is fully paid for over 10 years. Every day that Americans are out of work is another day that the country is hurting and the deficit is growing.

The fastest and most effective way to reduce the deficit in the short term is to put Americans back to work. I hope this committee will address that reality in our work as we move forward.

Second, yesterday, as Senator Kerry mentioned, the co-

chairs of the Bipartisan National Commission on Fiscal Responsibility, Alan Simpson and Erskine Bowles, called upon this committee to "go big," urging us to use this unique opportunity to develop a plan to reduce the deficit by about \$4 trillion over 10 years, including the almost \$1 trillion in savings from the Budget Control Act. They are right. I believe we should proposal a plan of that size.

The bipartisan Simpson-Bowles commission, the bipartisan Rivlin-Domenici commission, as well as the Gang of Six, have provided us with a framework of how to achieve that goal. What is clear in all of them is that we need a balanced approach to reduce the deficit, one that contains savings achieved from modernizing certain programs, as well as savings gained by simplifying and reforming the tax code in a way that generates revenue.

Addressing a problem of this magnitude requires shared responsibility in order to grow our economy and reduce the deficit. The testimony we will hear today from Mr. Elmendorf demonstrates why such a balanced approach is necessary. It vividly illustrates the policy choices driving our deficit are the significant cuts made to revenue, combined with increasing retirement and healthcare

costs due to the retirement of the baby boomers.

Let's not duck those realities. Let's follow the advice of the three other bipartisan commissions and go big. I don't agree with every one of their proposals, but those three groups have provided this bipartisan group with a framework from which to start.

Time is short. The clock is ticking. I hope we will get to work and follow that balanced framework approach that has been set by, again, three other bipartisan groups that look to tackle the issues that this committee is asked to address.

Thank you, Madam Chairman.

Co-Chair Murray. Thank you.

Senator Toomey?

Senator Toomey. Thanks, Madam Chair.

And Dr. Elmendorf, thank you. I look forward to working with you as well.

Just a couple of points I wanted to stress. I think the point has been made, but I want to underscore that the problem that we face is, of course, much worse than what the current law baseline would seem to suggest. That is not a criticism. It is simply an observation.

The current law baseline is not meant to be a predictor of the future. If it were, it would be a really bad one, as we know.

In addition, some things have changed since you did that. The economy has gotten weaker. I would argue the sovereign debt crisis in Europe has gotten worse. So these things have aggravated the situation.

And then there is the fact that I think the risks are greater for downside surprises than upside surprises, if you will -- things like the contingent liabilities that are lurking out there, which could come home to roost at any point in time.

The assumptions that you make about interest rates are not necessarily unreasonable. But if they are wrong, it is most likely that rates will be much higher rather than lower, significantly aggravating our problem. So I want to underscore that I think we should be striving to do every bit as much as we possibly can.

I hope that we will be able to dwell somewhat today on just how significantly the big entitlement programs are the long-term drivers of this problem. And I hope we will be able to discuss what I see as a real danger in taking the

approach that I think you might be advocating, although I am not entirely clear -- the danger of delaying the spending cuts for fear that we will weaken a fragile economy.

On page 29 of your testimony, you do go through a list of the risks associated with delaying spending cuts now. I would argue that if we tolerate or aggravate the current deficit problem with the promise that we will work it all out in the future, that is a very, very dangerous direction to head in. And at the end of the day, there is no free lunch, and a Government spending expansion here is actually going to do more harm than good.

So, finally, the one point that I really want to underscore is just the importance of growth. If we can have policies that will encourage maximizing economic growth, all problems are easier to solve with a strong, growing economy. And I think that should guide our decisions.

With that, Madam Chair, I yield the balance of my time.

Co-Chair Murray. Thank you very much.

With that, we will turn to our witness for today. Dr. Douglas Elmendorf is the eighth Director of the Congressional Budget Office. His term began on January 22,

2009.

Before he came to CBO, Dr. Elmendorf was a senior fellow in the Economic Studies Program at Brookings Institution. As the Edward M. Bernstein Scholar, he served as co-editor of the Brookings Papers on Economic Activity and the Director of the Hamilton Project, an initiative to promote broadly shared economic growth.

He has served as an assistant professor at Harvard University, a principal analyst at the Congressional Budget Office, a senior economist at the White House Council of Economic Advisers, a Deputy Assistant Secretary for Economic Policy at the Treasury Department, and an Assistant Director of the Division of Research and Statistics at the Federal Reserve Board. In those positions, Dr. Elmendorf has gained a wide range of expertise on budget policy, Social Security, Medicare, national healthcare reform, financial markets, macroeconomic analysis and forecasting, and many other topics.

So I am very glad that he has agreed to join our committee here today. Dr. Elmendorf, thank you so much for taking the time and for helping us get through this. And we would look forward to your testimony.

STATEMENT OF DOUGLAS ELMENDORF, PH.D., DIRECTOR,
CONGRESSIONAL BUDGET OFFICE

Dr. Elmendorf. Thank you, Senator Murray, Congressman Hensarling, and all the members of the committee.

I appreciate the invitation to talk with you today about the economic and budget outlook and about CBO's analysis of the fiscal policy choices facing this committee and the Congress.

The Federal Government is confronting significant and fundamental budgetary challenges. If current policies are continued in coming years, the aging of the population and rising costs for healthcare will push up Federal spending measured as a share of GDP well above the amount of revenue that the Federal Government has collected in the past. As a result, putting the Federal budget on a sustainable path will require significant changes in spending policies, significant changes in tax policies, or both.

Addressing that formidable challenge is complicated by the current weakness of the economy and the large numbers of unemployed workers, empty houses, and underused factories and offices. Changes that might be made to Federal spending

and taxes could have a substantial impact on the pace of economic recovery during the next few years, as well as on the Nation's output and people's income over the longer term.

I will talk briefly about the outlook for the economy and the budget and then turn to some key considerations in making fiscal policy. The financial crisis and recession have cast a long shadow on the U.S. economy. Although output began to expand 2 years ago, the pace of recovery has been slow, and the economy remains in a severe slump.

CBO published its most recent economic forecast in August. That forecast was initially completed in early July and updated only to incorporate the effects of the Budget Control Act. In our view, incoming data and other developments since early July suggest that the economic recovery will continue, but at a weaker pace than we had anticipated.

With output growing at only a modest rate, CBO expects employment to expand very slowly, leaving the unemployment rate, as depicted by the dots in the figure, close to 9 percent through the end of next year. I should say all these figures are taken from the written testimony and

nearly in the order in which they appear in the testimony.

As a result, we think that a large portion of the economic and human costs of this downturn remain ahead of us. The difference between output and our estimate of the potential level of output, shown by the gap between the lines in the figure, has cumulated so far to about \$2.5 trillion. By the time output rises back to its potential, which will probably be several years from now, we expect that cumulative shortfall to be about twice as large as it is today, or \$5 trillion.

Not only are the costs associated with this shortfall and output immense, they are also borne unevenly, falling disproportionately on people who lose their jobs, are displaced from their homes, or own businesses that fail.

I want to emphasize that the economic outlook is highly uncertain. Many developments could cause economic outcomes to differ substantially in one direction or the other from those we currently anticipate. If the recovery continues as expected and if tax and spending policies unfold as specified in current law, deficits will drop markedly as a share of GDP over the next few years.

Under CBO's baseline projections, shown by the dark

blue portion of the bars in the figure, deficits fall to about 6 percent of GDP in 2012, about 3 percent in 2013, and smaller amounts for the rest of the decade. In that scenario, deficits over the decade total about \$3.5 trillion.

But as a number of you have said, those baseline projections understate the budgetary challenges because changes in policy that will take effect under current law will produce a Federal tax system and spending for some Federal programs that differ sharply from the policies that many people have become accustomed to.

Specifically, CBO's baseline projections include the following policies specified in current law. First, certain provisions of the 2010 Tax Act, including extensions of lower rates and expanded credits and deductions enacted in 2001, 2003, and 2009, all expire at the end of next year.

Second, the 2-year extension of provisions designed to limit the reach of the alternative minimum tax, the extensions of emergency unemployment compensation, and the 1-year reduction in the payroll tax all expire at the end of this year.

Third, sharp reductions in Medicare's payment rates

for physician services take effect at the end of this year.

Fourth, funding for discretionary spending declines over time in real terms in accordance with the caps established under the Budget Control Act.

And fifth, additional deficit reduction of more than \$1 trillion will be implemented as required under the act.

Changing provisions of current law so as to maintain major policies that are in effect now would produce markedly different budget outcomes.

For example, and shown by the full bars in the figure, if most of the provisions of the 2010 Tax Act were extended, if AMT was indexed for inflation, and if Medicare's payment rates for physician services were held constant, then deficits over the coming decade would total \$8.5 trillion, rather than the \$3.5 trillion in the current law baseline. By 2021, debt held by the public would reach 82 percent of GDP, higher than in any year since 1948.

Yesterday, CBO released an analysis of the enforcement procedures of the Budget Control Act. As shown in the slide, we estimate that if no legislation originating from this committee is enacted, the following would occur over the next decade.

Reductions in the caps on discretionary appropriations for defense would cut outlays by about \$450 billion. Reductions in the caps on discretionary appropriations for nondefense purposes would cut outlays by about \$300 billion. And reductions in mandatory spending would yield net savings of about \$140 billion. The total reduction deficits would be about \$1.1 trillion.

The estimated reductions in mandatory spending are comparatively small because the law exempts a significant portion of such spending from the enforcement procedures. As a result, about 70 percent of the total savings would come from lower discretionary spending. Cuts in defense and nondefense spending of that magnitude would probably lead to reductions in the number of military and civilian employees and in the scale and scope of Federal programs.

Beyond the coming decade, as you know, the fiscal outlook worsens, as the aging of the population and rising costs for healthcare put significant and increasing pressure on the budget under current law. When CBO issued its most recent long-term outlook in June, debt held by the public was projected to reach 84 percent of GDP in 2035 under current law and about 190 percent of GDP under policies that

more closely resemble the current policies.

Although new long-term projections would differ because we would incorporate the latest 10-year projections, the amount of Federal borrowing that would be necessary under current policies would be clearly unsustainable. In sum, the Federal budget is quickly heading into territory that is unfamiliar to the United States and to most other developed countries as well.

As this committee considers its charge to recommend policies that would reduce future budget deficits, its key choices fall into three broad categories listed in the slide. How much deficit reduction should be accomplished? How quickly should deficit reduction be implemented? What form should deficit reduction take? Let me take up these questions briefly in turn.

First, regarding the amount of deficit reduction, there is no commonly agreed upon level of Federal debt that is sustainable or optimal. Under CBO's current law baseline, debt held by the public is projected to fall from 67 percent of GDP this year to 61 percent in 2021. However, stabilizing the debt at that level would still leave it larger than in any year between 1953 and 2009.

Lawmakers might determine that debt should be reduced to amounts lower than those shown in CBO's baseline and closer to those we have experienced in the past. That would reduce the burden of debt on the economy, relieve some of the long-term pressures on the budget, diminish the risk of a fiscal crisis, and enhance the Government's flexibility to respond to unanticipated developments. Of course, it would also require larger amounts of deficit reduction.

Furthermore, lawmakers might decide that some of the current policies scheduled to expire under current law should be continued. In that case, achieving a particular level of debt could require much larger amounts of deficit reduction from other policies.

For example, if most of the provisions in the 2010 Tax Act were extended, the AMT was indexed for inflation, and Medicare's payment rates for physicians were held constant, then reducing debt in 2021 to the 61 percent of GDP projected under current law would require other changes in policies to reduce deficits over the next 10 years by a total of \$6.2 trillion, rather than the \$1.2 trillion needed from this committee to avoid automatic budget cuts.

In 2021 alone, the gap between Federal revenues and

spending if those policies were continued and no other budgetary changes were made, as shown by the right pair of bars in the figure, is projected to be 4.7 percent of GDP. Putting debt on a downward trajectory relative to GDP in that year would require a much smaller deficit. Reaching that objective, declining debt relative to the GDP from that starting point would require a reduction in the deficit of about 2.5 percent of GDP, or \$600 billion in that year alone.

Your second set of choices involves the timing of deficit reduction, which involves difficult tradeoffs summarized in the slide. On one hand, cutting spending or increasing taxes slowly would lead to a greater accumulation of Government debt and might raise doubts about whether the longer-term deficit reductions would ultimately take effect.

On the other hand, implementing spending cuts or tax increases abruptly would give families, businesses, and State and local governments little time to plan and adjust. In addition, and particularly important given the current state of the economy, immediate spending cuts or tax increases would represent an added drag on the weak economic expansion.

However, credible steps to narrow budget deficits over the longer term would support output and employment in the next few years by holding down interest rates and reducing uncertainty, thereby by enhancing confidence by businesses and consumers. Therefore, the near-term economic effects of deficit reduction would depend on the balance between changes in spending and taxes that take effect quickly and those that take effect slowly.

As shown in this next slide, credible policy changes that would substantially reduce deficits later in the coming decade and beyond without immediate spending cuts or tax increases would both support the economic expansion in the next few years and strengthen the economy over the longer term.

Moreover, there is no inherent contradiction between using fiscal policy to support the economy today while the unemployment rate is high and many factories and offices are underused and imposing fiscal restraint several years from now when output and employment will probably be close to their potential. If policymakers wanted to achieve both a short-term economic boost and longer-term fiscal sustainability, the combination of policies that would be

most effective, according to our analysis, would be changes in taxes and spending that would widen the deficit today, but narrow it later in the decade.

Such an approach would work best if the future policy changes were sufficiently specific, enacted into law, and widely supported so that observers believe that the future restraint would truly take effect.

Your third set of choices involves the composition of deficit reduction. Federal spending and revenues affect the total amount and types of output that are produced, the distribution of that output among various segments of society, and people's well-being in a variety of ways.

In considering the challenge of putting fiscal policy on a sustainable path, many observers have wondered whether it is possible to return to previous policies regarding Federal spending and revenues. Unfortunately, the past combination of policies cannot be repeated when it comes to the Federal budget. The aging of the population and rising costs for healthcare have changed the backdrop for budget decisions in a fundamental way.

Under current law, spending on Social Security, Medicare, and other major healthcare programs, the darkest

line in the figure, is projected to reach about 12 percent of GDP in 2021, compared with an average of about 7 percent during the past 40 years. That is an increase worth 5 percent of GDP. Most of that spending goes to benefits for people over age 65, with smaller shares for blind and disabled people and for nonelderly, able-bodied people.

In stark contrast, under current law, all spending apart from Social Security and the major healthcare programs and interest payments on the debt is projected to decline noticeably as a share of the economy. That broad collection of programs includes defense, the largest single piece; the Supplemental Nutrition Assistance Program, formerly known as food stamps; unemployment compensation; veterans benefits; Federal civilian and military retirement benefits; transportation; health research; education and training; and other programs.

That whole collection of programs has incurred spending averaging 11.5 percent of GDP during the past 40 years. With expected improvement in the economy and the new caps on discretionary spending, it falls in our projection by 2021 to less than 8 percent of GDP, the lowest share in more than 40 years, under current law and in our baseline

projections.

Putting those pieces together and including interest payments, between 1971 and 2010, as shown by the left pair of bars in the figure, Federal spending averaged about 21 percent of GDP. But under current law for 2021, as shown by the right pair of bars, CBO projects it to grow to about 23 percent of GDP.

Alternatively, if the laws governing Social Security and the major healthcare programs were unchanged and all other programs were operated in line with their average relationship to the size of the economy during the past 40 years, Federal spending would be much higher in 2021, around 28 percent of GDP. That amount exceeds the 40-year average for revenues as a share of GDP by about 10 percentage points.

In conclusion, given the aging of the population and rising costs for healthcare, attaining a sustainable Federal budget will require the United States to deviate from the policies of the past 40 years in at least one of the following ways. Raise Federal revenues significantly above their average share of GDP, make major changes in the sorts of benefits provided for Americans when they become older,

or substantially reduce the role of the rest of the Federal Government relative to the size of the economy.

My colleagues and I at CBO stand ready to provide the analysis and information that can help you in making these important choices.

Thank you. I am happy to take your questions.

[The statement of Dr. Elmendorf follows:]

Co-Chair Murray. Thank you very much, Dr. Elmendorf.

As we begin the work that has been outlined for us as a committee under the Budget Control Act, I think it is helpful for us to have a clear understanding of the scope of the problem, and you laid that out very clearly for us. I think we all agree this task is pretty enormous, and we have to come together around a balanced approach that addresses our fiscal situation, but also focuses on making sure that we remain competitive and looks at our long-term growth.

So I wanted to start by just asking you to expand a little bit on what you were just talking about and talk to us about what we should consider in weighing the tradeoffs between helping our economy in the short term to help create growth and not causing significant harm in the long term.

Dr. Elmendorf. In our judgment, and this is consistent with a consensus of professional opinion, cuts in spending or increases in taxes at a moment when there are a lot of unused resources in the economy -- unemployed workers, empty homes, unused factories and offices -- and when monetary policy is finding it difficult to provide further support for economic activity because the Federal funds rate is already very close to zero, then under those

conditions cuts in spending and increases in taxes will tend to slow the economic recovery. They will tend to reduce the levels of output and employment relative to what would otherwise be.

At the same time, and this is also quite consistent with a consensus professional opinion, over time, as our economy moves back toward potential output and those unused resources become used again, under those sorts of economic conditions, cuts in spending or increases in taxes that reduce outside budget deficits are good for the economy, bolster output and incomes.

That may seem like a paradox, but it isn't really. It is just reflecting the view that the effect of Federal fiscal policy on the economy depends on economic conditions and on the stance and abilities of monetary policy.

And that is why, in our judgment, the analysis that we have done and presented to the Congress on a number of occasions over the past few years, to provide the greatest boost to economic activity now and over the medium run and long run, the combination of fiscal policies likely to be most effective would be policies that cut taxes or increase spending in the near term, but over the medium and longer

term move in the opposite direction and cut spending or raise taxes.

Co-Chair Murray. Okay. Thank you.

Dr. Elmendorf, as you know, several bipartisan groups have released reports in the last 9 months with recommendations for reining in our deficit and spending and stemming the rise of Federal debt. All of them came with a balanced approach, and I am concerned that Congress has not yet included revenues or entitlements, as we have focused only so far on discretionary spending cuts and caps, when I think we need to be looking at balanced approaches.

Now some have made it clear that they want entitlements off the table. Others have made it clear they want revenues off the table. Unfortunately, that leaves only a relatively very small amount of discretionary and mandatory spending that Members so far have been willing to focus on.

Would you agree that while cuts and caps we instituted within the Budget Control Act can help somewhat with the long term, what we really need is a comprehensive approach that does address both revenue and mandatory programs?

Dr. Elmendorf. So, Senator, as a matter of

arithmetic, there are a lot of different paths to reducing budget deficits, and it is not CBO's role to make recommendations among those alternative paths. I think the crucial point, though, is that the more large pieces of the puzzle one takes off the table, then the greater the changes will need to be in the remaining pieces.

You can see this very clearly in this picture. In 2021, this picture shows, under current law, revenues being about 21 percent of GDP. If one instead wants to --

Senator Baucus. Can you explain that? We can't see it.

Co-Chair Murray. It is hard to see.

Dr. Elmendorf. I am sorry. So this is Figure 14 in the written testimony, if you have that in front of you? What the left-hand -- I will explain it.

Senator Baucus. Exhibit 14?

Dr. Elmendorf. Yes. Exhibit 14.

Senator Baucus. Thank you.

Dr. Elmendorf. Figure 14 in the written testimony. The left-hand set of bars shows the averages over the last 40 years. The far left bar is revenues. Revenues have averaged about 18 percent of GDP. Then the right-hand bar

shows the major pieces of spending. The bottom chunk is Social Security and major healthcare programs. This is --

Senator Baucus. Could you try a page?

Co-Chair Murray. Page 42.

Senator Baucus. Forty-two. Thank you.

Dr. Elmendorf. The left-hand piece, as I said, is revenues. They have averaged 18 percent of GDP. The right-hand bar shows spending, Social Security, and the major healthcare programs -- that is Medicare, Medicaid, now CHIP -- in the future, including subsidies to be provided through insurance exchanges. In the past, that has averaged about 7 percent of GDP.

All other non-interest spending -- that is other mandatory spending, it is defense spending, it is nondefense discretionary spending -- has averaged 11.5 percent of GDP. And interest payments have averaged about 2.25 percent of GDP. With the deficit, that has been a little under 3 percent.

For 2021, under current law, revenues would rise to be about 21 percent of GDP. Social Security and the major healthcare programs would be 12, a little over 12 percent of GDP. That is 5 percent of GDP more than the average for the

past 40 years, and that is the essence of the point that the aging of the population and rising costs for healthcare have changed the backdrop for the decisions that you and your colleagues make.

If those policies continue to operate -- those programs continue to operate in the way they have operated in the past, they will be much more expensive than they have been in the past because there will be more people collecting benefits, and each person will be collecting more in benefits. And that is the crucial driver of the future budget trajectory relative to what we have seen in the past.

The other category, other non-interest spending, as you can see, is already much smaller in 2021 under current law and our projections than it has been historically. And that is a combination of improvement in the economy, which we think will reduce the number of people on food stamps, collecting unemployment insurance, and so on, but also discretionary spending caps that reduce both defense spending and nondefense discretionary spending in real terms and thus reduce them fairly sharply as shares of GDP.

Co-Chair Murray. Dr. Elmendorf, I am out of time.

Dr. Elmendorf. Sorry.

Co-Chair Murray. And as chair, I am trying to keep everybody to that. But I appreciate that response and want to turn it over to my co-chair, Congressman Hensarling.

Co-Chair Hensarling. Thank you, Madam Co-Chair.

And Dr. Elmendorf, maybe we will continue on this line of questioning. Is it possible to pull up your Figure 12 from your testimony, if somebody could help me with that?

Dr. Elmendorf. Figure 12?

Co-Chair Hensarling. Page 39 of your testimony. I believe it is entitled Figure 12.

Now as I understand it, this chart is a chart of historic and projected growth on Social Security, Medicare, other major healthcare programs. You wouldn't happen to have this chart plotted against growth in GDP, would you?

Dr. Elmendorf. So these are shares of GDP. This is spending on these programs expressed as a percentage of GDP.

Co-Chair Hensarling. Okay. But historic average, post World War II GDP has averaged what, roughly 3 percent annual economic growth?

Dr. Elmendorf. I think that is about right, Congressman. I don't know for sure.

Co-Chair Hensarling. Okay. On your Figure 14, again,

Social Security and major healthcare programs have averaged 7.2 percent of GDP. Current law, going to 12.2 percent of GDP in just 10 years. So from 7.2 to 12.2, not quite double, but certainly that could be described as explosive growth, could it not?

Dr. Elmendorf. Very rapid, Congressman. Yes.

Co-Chair Hensarling. We won't parse terms. As I am looking at some of your CBO data just for the last 10 years, apparently Social Security has grown at an average of 5.8 percent, Medicare 9.1 percent, Medicaid 8.8 percent in the last decade. And again, we now have a revised GDP growth outlook coming out of your August revision of your baseline.

So is a fair assessment that we have Social Security, Medicare, other healthcare programs that are potentially growing two and three times the rate of growth in our economy?

Dr. Elmendorf. They have grown much faster in the past, and our projections are for them to continue to outpace economic growth. Of course, the exact amount is uncertain, but the gap in the growth rates that we have seen historically has been very large, as you said.

Co-Chair Hensarling. Now, Senator Toomey certainly in

his comments talked about the current law baseline, and although an important exercise, it is certainly not dispositive to the task in front of us. But under a current law baseline, Medicare physicians are due to take essentially a 30 percent pay cut next year. Correct?

Dr. Elmendorf. Yes. That is right.

Co-Chair Hensarling. Does CBO -- I believe recently you testified that CBO did not have a model to really impact -- to show the impact of such a cut on healthcare delivery. Is that correct? Is CBO developing a model, or is that beyond the scope of what you do?

Dr. Elmendorf. It is in the long-term plan, Congressman. We and others have raised concerns that the much slower growth projected for payments to physicians through Medicare relative to the private sector could affect the access to care or quality of care received by beneficiaries. But we do not have a model and are not about in the near term to have a model that would enable us to make any more specific predictions along those lines, I am afraid.

Co-Chair Hensarling. Well, what I am trying to get at is clearly -- and again, I quoted the President, who I don't

often agree with, in our last organizational meeting, where he said, "The major driver of our long-term liabilities, everybody here knows, is Medicare and Medicaid and our healthcare spending. Nothing comes close." And I take it you would probably agree with that assessment as well, Dr. Elmendorf?

Dr. Elmendorf. Yes. That is right.

Co-Chair Hensarling. But I am also trying to get to the qualitative aspect of this, too, in our current systems, and you say CBO is developing a model. I know that CMS actuaries have said as essentially if that under the current baseline that, "Medicare beneficiaries would almost certainly face increasingly severe problems with access to care." That is the Medicare actuaries, August of 2010.

The Medicare trustees 2011 report, talking about the growing insolvency, "Beneficiary access to healthcare services would be rapidly curtailed."

The President's Administrator for Centers for Medicare and Medicaid Services has said, "The decision is not whether or not we will ration care. The decision is whether we will ration with our eyes open."

So, to some extent, Dr. Elmendorf, even though CBO

doesn't have a model, we are looking at not just programs that are driving the insolvency of our country, but in many respects, left unreformed, is also shortchanging the beneficiaries as well. Would you agree with that assessment, or again, until you have your model, that is --

Dr. Elmendorf. I think all I can say, Congressman, is that the extent of the pressure on providers of care to Medicare beneficiaries may depend a lot on the time horizon over which one looks. When the actuaries make projections for 75 years into the future, they have shown a picture that I have seen in testimonies about the relative payment rates to providers many, many decades into the future.

The sorts of changes that are in train for the coming decade might affect access to care or quality of the care, as I have said, but would be much less severe in those effects than if those same policies were left in place for the remainder of the 75-year period that the actuaries make projections for. So, but beyond that, we just don't have a way of trying to quantify for you the extent of the impact on beneficiaries.

Co-Chair Hensarling. Apparently, the trustees in CMS do so far. In an attempt to lead by example and follow the

lead of my co-chair, I see my time is now ended.

Thank you, Dr. Elmendorf.

Dr. Elmendorf. Thank you.

Co-Chair Murray. Representative Becerra?

Mr. Becerra. Dr. Elmendorf, thank you very much for your testimony, and you focused quite a bit of your time on what is coming up, which, if we are not careful, could be pretty bad.

But we are dealing right now with a \$14 trillion national debt plus -- \$14 trillion-plus national debt and fairly massive deficits today, and we have been charged to come up with savings from these current and past deficits of at least \$1.5 trillion.

And so, let me ask that a few charts that I have, the first chart actually is a chart CBO's work done in 2001 that I would like to have raised. It is called "Changes in CBO's Baseline Projections of the Surplus Since January 2001," and what I would like to do on that chart, if we can get that up, is just point out what was being projected by your office back in 2001 and then analyze -- and I think all my colleagues have copies of those charts with them -- and analyze that.

Now it is very difficult to make out these tables and make much sense of them. But for those who can make out the lines, the numbers on those charts, the very top line, the total surplus as projected in January --

Senator Baucus. Xavier, could you tell us what page that is on?

Mr. Becerra. It should be a separate package that you got --

Senator Baucus. Oh, it is a handout.

Mr. Becerra. It is a separate handout. That is correct. It should be --

Dr. Elmendorf. I think this is a table that CBO has published and posted on its Web site, but it is not included in the testimony that I brought today.

Mr. Becerra. That is correct. And I only will make a couple of points here since it is difficult to read all the numbers on the table. But the first one is that the top line there, total surpluses as projected in January 2001, projected that after -- from 2001 to 2011, if you totaled it up, we have surpluses of \$5.610 trillion.

And if you go down to the very bottom of the chart, towards the very bottom, to the line that says "Actual

Surplus or Deficit," under the year 2002 column, by the year 2002, there was a negative 158, which means a deficit of \$158 billion.

So that while the projections in 2001 were for record surpluses totaling over 10 or so years, \$5.6 trillion, by the second year, by 2002, we were already beginning to run deficits, not surpluses. So we knew well in advance of the year 2011 that the Federal Government was beginning to run deficits -- in fact, record deficits -- that could ultimately harm our economy.

I have another chart that uses the data from the CBO that we just discussed and tries to put it in a little easier form to analyze. And the Pew Center did this chart, taking the data from the Congressional Budget Office to try to segment out where that change from surplus to deficit went. All those dollars that were spent, all the revenue through the tax code that was lost, where did it go?

And obviously, the biggest piece of the pie on the right, technical and economic, that is what I think you described earlier as shortfall in Nation's output. In other words, all the things that have caused us to have less output than we had expected, projected. The recession and

so forth probably constitutes the biggest portion of that.

After that, the second biggest slice of the pie that drove our deficits, you can see, are the tax cuts in 2001 and 2002, the Bush tax cuts. Actually, you could put together our defense costs, which are here in the very bottom, "Operations in Iraq and Afghanistan" at 10 percent, and "Other Defense Spending," a little bit further up to the left, at 5 percent, and you have 15 percent of the pie due to defense spending, and so on.

And interestingly enough, increase in net interest, money we pay just on the interest we owe on that national debt, is one of the largest items as well. So nothing productive comes of making those payments.

I raise all that because as we talk about where we should target our solutions, we should know what has driven us most towards these large annual deficits that now give us this over \$14 trillion national debt.

And the final chart that I wanted to raise because it also points out the actual discretionary spending part of the pie, which you spent some time on -- not the tax expenditures, not the spending we do through the tax code, which is the largest portion, but through the allocations we

make every year through the budgeting process, the appropriation process. Hard to tell again, unless you have a chart in your hand, but the largest item shows the change in spending from 2001 to 2010, the greatest percentage of that added spending in those 10 years was in the Department of Defense, much of it because of the war in Iraq and the war in Afghanistan. But fully two-thirds of the costs or the extra spending that was done from 2001 to now 2010 has come in spending done in the Department of Defense.

You could compare that to, say, the Veterans Department, Veterans Affairs Department. The share of the new spending over that 10-year period that went to veterans was about 5 percent. Education, you can see further down the list. The new spending beyond what was expected in 2001, it is about 1 percent.

And I think that is important to sort of gauge that. And as much as I hope we have a chance to get into some of this and talk about where we have to go, I think it is important to know where we are coming from. And so, I thank you for being here to help us gauge those responses into the future.

I yield back.

Co-Chair Murray. Senator Kyl?

Senator Kyl. Thank you, Madam Chairman.

Rather than make a speech, which would probably have the effect of dividing us if I responded to my colleague, I would like to focus on areas where we might find agreement, going back to my opening statement, and to begin with a quotation from the President.

In March of last year, he said, and I quote, "It is estimated that improper payments cost taxpayers almost \$100 billion last year alone. If we created a Department of Improper Payments, it would actually be one of the biggest departments in our Government."

Well, this committee can address the question of improper payments, but I think we are going to need CBO's help in order to do that. For 2010, GAO estimated total improper payments at over \$125 billion. And according to its report, Medicare, Medicaid, and unemployment insurance ranked 1, 2, and 3 in total improper payments. Their figures were slightly below those I quoted earlier.

But the bottom line is that if you had \$100 billion, as the President says, in overpayments each year, over a decade, that is \$1 trillion. More than \$1 trillion when you

compound it. It is an area we need to address.

And since it doesn't involve cuts in benefits or fundamental reform of programs -- which I happen to think we should do, but I am trying to stay on areas where we can reach bipartisan consensus here -- we are going to need help in scoring how to approach this.

My first question I guess I should ask is do you agree, whether it is with these specific numbers or not, with the President's contention, let's just say, that at least there is a significant amount of inappropriate payment for some of the programs that I have mentioned?

Dr. Elmendorf. So I agree with that. I have got two quick comments. One is that there is a difference, of course, between improper payments and fraud. Fraud is a much narrower category involving certain legal issues.

Some improper payments are simply that people didn't put Social Security numbers into forms where they should have or so on. And if the forms were filled out properly, the payments might be still made.

So just people should understand that when they see some of these largest numbers for improper payments, that is a much broader set of situations than the sort of thing that

we read of prosecutions regarding in the newspaper.

Second point to make, of course, is not just whether the improperness or the fraud is out there, but what policy levers the Government has to go after that. Of course, those programs are not trying to encourage improper payments or fraud. There is an active effort on the part of the Justice Department, as well as the part of the departments running these programs, to crack down on fraud. And you do see stories in the newspaper about prosecutions.

So the question that we can help the committee work on is what policy levers are available that can try to wring some of that money out of the system?

Senator Kyl. Exactly so. And that is where we need your advice. And the comment about fraud is obviously correct. I think fraud is not the most significant part of these overpayments, but it is important.

One question is would we benefit in a cost-benefit analysis by devoting more resources to trying to root that out? We should deal with that. Another would deal with whether or not hiring additional people to check before the check goes out rather than audit after we find the problem would be beneficial.

The prompt payment requirements represent part of the challenge that we have here, as I understand it. So, now, is it true that CBO has -- well, let me just ask, has CBO itself done an analysis of these numbers?

Dr. Elmendorf. I don't have numbers comparable to the ones you quoted to use. But we do spend a fair amount of time working with Members of Congress, working with the people at CMS, and so on to think about ways that policies could be changed that would try to reduce the level of those payments.

And as you know, the Budget Control Act, in fact, included provisions for raising the caps in discretionary spending to cover some of those increased efforts that you described.

Senator Kyl. Right.

Dr. Elmendorf. And we included in our estimate of the effects of that act the savings that we thought would accrue in terms of reduced payments.

Senator Kyl. Well, just to summarize, will you work with us to try to help us identify the potential policy that could result in, on a cost-benefit analysis, significant savings if we were to implement it?

Dr. Elmendorf. Yes. We certainly will. But can I just also caution, I am not against our working with you on any issue that you want us to work with you on, but there is no evidence that suggests that this sort of effort can represent a large share of the \$1.2 trillion or \$1.5 trillion or the larger numbers that some of you have discussed as being the objective in savings for this committee.

Senator Kyl. Well, the GAO, if the GAO report is right, if what the President said is right, if there is over \$100 billion in just one year alone, then even if we get 25 percent of that, it is a significant amount of money. It is at least something that I think on a bipartisan basis we can agree on because it doesn't involve fundamental reform of the program, it seems to me.

Now there is a second area that I wanted raise here, too, and that is asset sales. There are a lot of different reports. CRS, for example, in 2009 said the Government held well over 10,000 unneeded buildings, spending \$134 million just to maintain them. The President's budget assumed savings by selling property and so on.

One of the things we would also like to ask you to do,

and I know you have scored the President's proposal, but that was a proposal that relied on incentives to sell property. If we simply mandated the sale of property, I think we would need your advice about how to structure that so that we would get the best return for the sales that we would want to accomplish.

Will you work with us on that potential area of -- that is revenue rather than savings, but it all amounts to the same thing in terms of helping us with our problem.

Dr. Elmendorf. Yes, Senator. Of course, we will work with you. I would caution again. We have done a fair amount of work. We have given testimony on this topic, and there is no evidence that the amount of savings that could be -- or extra revenue that could be reaped by the Government through efforts in this direction could represent any substantial share of numbers that begin with "t" for trillion.

The Base Closure and Realignment effort has not yielded significant amounts of money for the Government in terms of selling the property. It saved money in terms of operating some of these facilities, but not much has been sold.

When one sees these numbers of thousands of Government properties not being used, many of them by number are shacks in the middle of nowhere that don't have market value. And the properties that have the most value -- there has been some back and forth I have seen in the newspapers about property in Los Angeles -- then the people who live around it are fighting very hard to prevent the Federal Government from selling it.

Not to discourage you from passing laws to the contrary. But what happens are the things that are most valuable is that the people who are there are using it or potentially using it or want the area to stay that way tend to push back very hard, and history suggests that very little money is actually reaped.

But we are certainly ready to work with you on policies in that direction.

Co-Chair Murray. Senator Baucus?

Senator Baucus. Thank you, Senator Murray.

Again, I want to follow up with Senator Kyl's questions. I think we should explore this much more vigorously than we have in the past, and I think you and I and others will try to work with you to try to find some

solutions here.

On the version I have of your statement, it is page 5. You are talking about the timing of deficit reduction, and you state that according to analysis, essentially, credible policy changes that would substantially reduce deficits later in the coming decade for the longer term, the thought being spending, cuts in spending are efficient, would both support economic expansion in the next few years and the strength of the economy longer term.

My basic question is, could you give us some examples about how we could achieve both goals, namely jobs and deficit reduction? That is really one of the key questions here is how do we do this?

There are probably several ways. You mentioned that deficit reduction has to be, in the longer term, credible because we can't do something that is not credible. It has got to work, but we have got to find the balance. And I wondered if you could give us a couple examples in how we accomplish that?

Dr. Elmendorf. Well, there are a number of possibilities, Senator. We released a report in January of 2010 that analyzed a set of alternative proposals for

spurring job growth. We looked at increased transfer payments. We looked at cuts in all sorts of different types of taxes. We looked at other types of Government spending increases.

And I don't want to be appearing to steer the committee in any particular direction among those choices because the choices involve not just the effects on the economy -- and we did estimate quantitatively the impact on output and employment. They also involve choices about what you want the Government to do, what sorts of activities it should be engaged in, what the role of the Government should be relative to the private sector.

So the set of choices in making stimulative policy, in addition to doing deficit reduction policy, are far beyond our technical role. I think the crucial points, though, are that cuts in taxes or increases in spending in the near term will spur output and employment in the near term. But just by themselves, they will reduce output and incomes later on because of the extra debt that is accumulated.

Senator Baucus. Right. I --

Dr. Elmendorf. If one wants to also improve the medium and longer-term outlook for the economy, then one

needs to have deficit reduction that offsets the extra costs in the near term and reduce the deficit further relative to the unsustainable path of current policies.

Senator Baucus. I appreciate that. In fact, I think I have your chart, your table, that is entitled "Estimated Effects of Policy Options on Output and Employment." And I applaud you for it because, according to that chart, you, for example, with respect to jobs as to cumulative effects on employment, in 2010, '11, '10 to '15, you have highs and lows that you rate. You know, this creates more jobs than that.

So you give us a sense of what -- for example, increasing the aid to the unemployed is very high in terms of its economic effect and helping people without jobs, but also with respect to the economy and GDP. So I appreciate that, and I will work with you to try to find ways to address that.

I would like to turn to another question, and that is I don't want to steal from my good friend Rob Portman. He can follow up a lot more. But it is sort of the baseline question. And you say that we can get to 61 percent of GDP in 2021 under current law. But I think most of us here in

this room don't think that current law is very realistic. There are going to be changes, and you list some of the changes in your statement, namely, the tax cuts -- 2010 tax cuts, AMT indexed for inflation, Medicare payment rates, and so forth.

And if we were to assume that those provisions are going to be extended as something called the current policy, that instead of trying to get -- instead of \$1.2 trillion as to 61 percent of GDP in 2021, the figure I have is about \$6.2 trillion.

Dr. Elmendorf. Yes. That is right. The cost of extending those expiring provisions amounts to about -- including the interest cost that would result, amounts to about \$5 trillion over the coming decade. So the choice of the Congress about those policies is much larger an impact potentially than the stated target deficit reduction of this committee.

Senator Baucus. All right. So let's say we want to reduce the deficit by, what, 6.2 -- 5 plus 1.2 is 6.2, let's say, for example.

Dr. Elmendorf. Okay.

Senator Baucus. What would the composition of that

reduction be if we reduce the deficit somewhat in parallel, in tandem with proportion to the causes of the additional \$5 trillion? I guess it would just be --

Dr. Elmendorf. Well, most of the extra \$5 trillion under your scenario comes from a reduction in taxes. So if one wanted to offset that, that is what you are suggesting, then one would need to raise significant tax revenue through some other channel.

I mean, I think I understand the purpose for this hearing of talking about the history of debt and how we got here. And I think you are extending that a bit into the future, looking at what policy changes would get us to a certain place. But I think really the fundamental question for you is not how we got here, but where you want the country to go. What role do you and your colleagues want the Government to play in the economy and the society?

Senator Baucus. That is right.

Dr. Elmendorf. And if you want a role that has benefit programs for older Americans like the ones we have had in the past and that operates the rest of the Government like the ones we have had in the past, then more tax revenue is needed than under current tax rates.

On the other hand, if one wants those tax rates, then one has to make very significant changes in spending programs for older Americans or other aspects of how the Federal Government does its business.

Senator Baucus. That is exactly right, and I don't want to take time here. But it is just really the question. Where do we want to go? And do we want to have AMT indexed, for example? Do we want to have SGR, the physicians payment rate? Do we want to increase taxes for middle-income Americans beginning 2013, or upper income, or not?

I mean, these are basic questions we are going to have to ask ourselves, and they all have consequences, really. And the consequences if we want to do all that is what we just agreed on. Namely, it is a \$5 trillion addition to our job here. But in addition, we have what the President is going to have us do with his jobs plan.

Thank you.

Dr. Elmendorf. Yes, Senator.

Co-Chair Murray. Representative Upton?

Mr. Upton. Well, thank you again, Dr. Elmendorf.

I want to underscore what our friend Mr. Kyl said about fraud and abuse. I mean, there is nothing more

irritating to any of us here or certainly to our constituents, and any assistance that you could help us on that I know would be low-hanging fruit in a major way for us to include as part of the package.

Let me ask just an early question as to timing of this whole event. We are tasked to have a vote prior to November 23rd. What is the timing -- I mean, other than as soon as possible. What is the realistic date that truly we have to have our documentation submitted to you?

I know sometimes a lot of our Members are frustrated trying to get a CBO score. I know that there is not a higher priority for you all to do this. But what is really the date that you are going to want the material so that we can complete the work by the statute?

Dr. Elmendorf. As you know, Congressman, from your work on the Energy and Commerce Committee, in order to process --

Mr. Upton. Which would feed into the queue ahead of Ways and Means in terms of the committee --

[Laughter.]

Dr. Elmendorf. It is an iterative process in which we often see preliminary versions of ideas and offer some

preliminary feedback. But if this committee intends to write legislation that would change entitlement programs in specific ways, that process usually takes weeks of drafting to make sure that the letters of the law that you are writing accomplish the policy objectives that you are setting out to accomplish.

And as part of that drafting process is our estimating ultimately the effects of the letter of the law as it is being written. So it will take us at least a few weeks.

I have a terrific set of colleagues who are incredibly talented and work unbelievably hard. But we need to do our jobs right, and that means not just pulling numbers out of the air. So we have said in discussions with some of the staff of the committee that, with all respect, your decisions really need to be mostly made by the beginning of November if you want to have real legislation and a cost estimate from CBO to go with that before you get to Thanksgiving.

Mr. Upton. Now I want to get a better understanding of some of the estimates of the cost impact to the Affordable Care Act. As we know, the bill increased taxes on some of our Nation's most innovative job creators,

reduced Medicare spending significantly. The tax increases and Medicare cuts were traded to create three new entitlement programs, which have yet to take effect, and according to our staff's projections, which are based on your most recent baseline, those new entitlement programs will cost the Nation nearly \$2 trillion over the first 10 years from '14 to 2023.

So, question one, have you all estimated the full 10-year costs for each of these entitlement programs, Medicaid, health coverage subsidies and the creation of the CLASS Act, for the '14 to '23 period when they are fully implemented?

Dr. Elmendorf. No, Congressman. We have not.

Mr. Upton. Do you anticipate doing that at all?

Dr. Elmendorf. No. As you know, we produced estimates for the 10-year period that was under consideration when the law was being considered, and then we provided a rougher sense of what we thought would happen in the second decade from that point in time.

As the time moves forward and the budget window moves out, we will ultimately end up with a 10-year budget window that will be from 2014 to 2023. But even then, it is not obvious that we will have an estimate of the effects of that

legislation by itself.

Some pieces of that legislation create new institutions, new flows of money that didn't exist before, insurance exchanges and subsidies. And those lines of our cost estimate will, in some sense, become real flows of money at that point in time.

But much else of that legislation made changes in existing programs, in payments through Medicare and so on. And we will never know for sure what money actually is flowing differently because of that piece of legislation. We will see flow for certain purposes through certain accounts, but isolating the effects of that legislation won't really be possible.

The prescription drug benefit is one of the few pieces of legislation where we can look back at how we did. In a sense, that is because much of that legislation -- not all, but much of it, the big part -- created a whole new stream of money that would have been zero otherwise. So we can see the difference.

But for most legislation that the Congress passes, one can never really go back and tell. That is the risk of our table that we gave to Congressman Becerra and others. One

can never really go back and tell what happened. And so, the healthcare legislation will be like that at some point.

Mr. Upton. Well, if there is a way that you would take the percentage of GDP and try to match that up with the outyears and look at 9, 10, 11, 12 years out? Is that a thought that you might take up?

Dr. Elmendorf. Well, so we did. So we can talk with you further, Congressman. We did do an estimate as the net effect of the law, the share of GDP over the second 10 years. And we talked in our estimates at the time about some of the bigger pieces of the legislation, things that were growing rapidly or growing more slowly or so on.

That sort of calculation is not really possible to do on the level of little specific provisions. It is just too broad a brush we need to paint with at that horizon, given the uncertainty involved. But if there are other ways of looking at those pieces that would be helpful to you, we are happy to try to do that.

I think we made very clear -- I hope nobody is confused about this -- that legislation created significant new entitlements that raise Federal outlays. It also made other reductions in outlays and raised revenues in ways that

on balance we think and still think reduce budget deficits. But that was a net effect of very large changes with different signs, and that increases the uncertainty surrounding those estimates of the net effects.

Mr. Upton. Thank you.

Co-Chair Murray. Thank you.

Representative Clyburn?

Mr. Clyburn. Thank you very much, Madam Chair.

Dr. Elmendorf, since we have been sitting here, we received notice that the Nation's poverty rate has increased to 15.1 percent, up almost a full percentage point. Now back in, I think it was September 2010, in testimony before the Senate Budget Committee, you said this.

"Regarding structural changes, the end of the housing boom, and the recession have all induced a reshuffling of jobs among businesses, occupations, industries, and geographical areas. Those developments suggest that gains in employment in the next several years will rely more than usual on the creation of new jobs with different businesses in different industries and locations and requiring workers with different skills."

Do you still feel that to be true?

Dr. Elmendorf. Yes, we do, Congressman. We think that much of the extra unemployment we are seeing now is what economists would call a cyclical response to a weakness in the demand for goods and services. But that some of the extra unemployment we see now is more what economists call a structural problem, which involves, importantly, the mismatches that we discussed in the passage you read, also relates to unemployment insurance benefits and other factors in the economy.

We made a rough attempt to quantify those pieces in our August update. But the upshot of that is to say that we think there is an important piece of current unemployment that relates to this kind of structural mismatch that would -- makes it harder for those people to go back to work, because it is not so much going back as it is going on to something else.

Mr. Clyburn. Then that means then your view is there is not much that can be done in the short term to attack this?

Dr. Elmendorf. I wouldn't quite say that. It is challenging. I mean, I think what I would say is that the cyclical part of the unemployment, that part that is

responsive to the weakness in demand for goods and services, can be addressed through aggregate economic policies.

The people who are unemployed for structural reasons, in a sense, because of the sort of the thing that they knew how to do in the place that they live isn't being done there or anywhere anymore, that isn't amenable to broad macroeconomic policy. It might be responsive to certain types of more focused policies -- training programs, for example.

I think the broad brush summary of training programs is that it is hard to make them work, but not impossible. I don't want to suggest that. But I think it is just a different sort of policy that would need to be considered in order to help some of those people find new jobs, to help other people create the jobs that those people would be able to do.

Mr. Clyburn. Well, just let me say, to be certain, I am just as concerned as my good friend Senator Kyl is about fraud and abuse. I want to cull that out of the system as well as we possibly can.

The problem I have got, though, is that with these kinds of numbers and with what you have just laid out, it

means that those in need are increasing rapidly. And the question then becomes if you look at the median family, household income declining 2.3 percent, that means that irrespective of what may be happening to people who may not be deserving of the assistance, there are increases occurring among the needy very rapidly, and we have not done anything to absorb that challenge.

Dr. Elmendorf. Certainly right, Congressman, about the number of people who are hurting. One thing I would say is that the Federal budget automatically does some things for those people. Food stamp participation is up. A lot more money is flowing out that way. Unemployment insurance, even apart from extensions, will pay benefits to more people if more people are unemployed.

So some of the automatic features of entitlement programs end up helping those people, but I don't want to suggest that that has inoculated them against the overall problems that they face.

Mr. Clyburn. That means our burden of doing smart cuts is greater than what it may appear just looking at the numbers. It means we really need to look into all of these programs and see exactly where cuts ought to be made rather

than just dealing with a number.

Thank you very much. I yield back.

Dr. Elmendorf. Yes, Congressman.

Co-Chair Murray. Senator Portman?

Senator Portman. Thanks, Madam Chair.

Building on what my colleague, Congressman Clyburn, just said and what Co-Chair Hensarling talked about earlier in terms of the impact of the deficit and debt on the economy, Dr. Elmendorf, have you got a reaction to the Rogoff and Reinhart study, which shows that once you are at 90 percent of gross debt, which we are already, that you have an impact on GDP, therefore on jobs, therefore on the kind of issues that Congressman Clyburn talked about?

Dr. Elmendorf. So we are certainly familiar with that work, Senator. Carmen Reinhart is a member of our panel of economic advisers. We benefit from her expertise.

I think the thing to note about the study, first of all, as it was said, is that they are looking at gross debt. So those are larger numbers than the numbers that you will see from me. We focus on debt held by the public.

Senator Portman. Right.

Dr. Elmendorf. The other thing to say is that they

divided the world into buckets in a sense, different levels of debt. That doesn't prove that there is some particular tipping point at 90 percent. It says that above -- but their evidence shows that above that level, economies tend not to do well.

We just had an issue brief last year about the risk of a fiscal crisis, and in other things that we have written, that we don't think it is possible to identify a particular tipping point. But there is no doubt that as debt rises, risks of fiscal crises rise. The Federal Government loses the flexibility to respond to unexpected international developments or problems at home because of this looming debt.

And we are, as I said, moving into territory that is unfamiliar to most developed countries for most of the last half century.

Senator Portman. In fact, in looking around the world, and there is a recent report by Alberto Alesina of Harvard University showing that the most successful and pro-growth test of reduction took place in countries that relied chiefly on austerity programs, spending cuts. And nations that relied more on tax increases were less successful in

reducing the deficits and had slower economic growth.

Have you looked at some of these countries that have gone through the same process we are going through now, and what comment can you give us today on what we can learn from the experience of those countries? And maybe if you know about Professor Alesina's study?

Dr. Elmendorf. So I do know Alberto's work. There have been a number of studies, as you know, looking at the international experience of countries that have faced fiscal crises and have undertaken austerity programs. The IMF looked at a very similar set of data to the work of Alberto and Silvia and came to a different conclusion, in fact. Their conclusion was that in countries that really set out to do fiscal austerity, the results tended to not be good in the short term.

I think the principal lesson of looking at countries like Greece and others is that it is a terrible situation to end up in, where one has to make drastic, abrupt changes in policy. But if you look at Greece or Ireland or the experience in the UK, which did not face such a crisis but has made a very determined pivot in its policy, those economies are not doing very well right now.

And I think leaders in those countries felt they had no alternative, given where they had gotten to, that they were at a point where people were not lending the governments money anymore or were about to stop lending them money, in the view of the governments. So they had to make drastic changes. But that is not a situation that we would like to find ourselves in as a country.

Senator Portman. It appears as though we are heading there if you look at the current policy baseline and some of the more realistic assumptions that my colleague, Senator Baucus, talked about. If you look at your chart with regard to baselines, you say that we have about a \$3.5 trillion deficit increase over the decade under the current law baseline, but under current policy that you have, you say it is about \$8.5 trillion.

I would add tax extenders in there like the R&D tax credit and others, and possibly, you are up to about \$9.3 trillion.

Dr. Elmendorf. Yes.

Senator Portman. So, again, the \$1.5 trillion is a relatively small part of the problem. It is about 17.5 percent, by the way, of your \$8.5 trillion number. So I do

think that as we look at our work, we are going to need your help on looking at more realistic baselines. We are making very difficult choices on things like alternative minimum tax, SGR, and ending the UI extension and payroll tax and so on.

In terms of what drives that, your Figure 14, I think, is very instructive, which talks about the major healthcare programs. Earlier, there was discussion about President Obama's comments. "The major driver of our long-term liabilities," he said, "everybody here knows is Medicare and Medicaid and our healthcare spending. Nothing comes close."

Assuming you agree with that, which I assume you do?

Dr. Elmendorf. Yes.

Senator Portman. What do you think ought to be the primary focus of this committee?

Dr. Elmendorf. Again, Senator, it is really not the place of me or CBO to offer recommendations about how to proceed. But there is no doubt that the aspect of the budget that is starkly different in the future relative to what we have experienced in the past 40 years is spending on programs for older Americans and spending on healthcare.

And the reasons those programs are so much more

expensive in the future is partly due to changes in policy over time, but most importantly due to a greatly increased number of older Americans and higher cost for healthcare. As a matter of arithmetic, it is possible to raise taxes or carve away at the rest of the Government in a way that can support those programs in this form for some time, but there should be no illusion about the magnitude of the changes required in other policies to accommodate that.

If one really leaves those programs in place, then, in fact, under current law already the rest of the Government would be much smaller relative to the size of the economy in 2021 than it has been historically. And one would need to raise revenues substantially.

I mean, this is a 5 percent of GDP increase in the cost of Social Security and major healthcare programs in 2021, relative to the 40-year average. Five percent of GDP is a very big number, and that is why I think many people believe that there should be changes in that part of the budget.

Senator Portman. So if the 22.7 percent of GDP is spending in that 2021 estimate under, again, current law and not even current policy, the major driver is Social Security

and major healthcare programs. That is as compared to the historic average the last 50 years of about 20.8 percent.

Revenues there go from 18 percent historic average up to 20.9 percent. My understanding is even under current policy, revenues go up above the 18 percent level. So your \$8.2 trillion --

Dr. Elmendorf. A little bit.

Senator Portman. -- or the \$9.3 trillion, which is I think a more realistic estimate, also includes a slight increase in revenues, is that correct, as a percent of GDP?

Dr. Elmendorf. I think a slight increase. Yes. That is right, Senator.

Senator Portman. Twenty-two percent, I think, is the number.

Dr. Elmendorf. I am not sure exactly. But, yes, a slight increase.

I would just add one fact here. The number of Americans over the age of 65 is going to rise by about one third in the coming decade. One third more beneficiaries of Social Security and Medicare a decade from now, roughly, than there are today. And on top of that, with higher healthcare costs per person, one can see why these programs

in their current form are becoming much more expensive over time.

Senator Portman. Thank you.

Co-Chair Murray. Senator Kerry?

Senator Kerry. Thank you, Madam Chairman.

Dr. Elmendorf, I want to try to move through a couple of things fairly quickly, if we can. You said a moment ago that the aspect of the budget that is starkly different is, I think you said, the number of older Americans and the cost of healthcare. Is that correct?

Dr. Elmendorf. Yes. That is right.

Senator Kerry. And those are the two things that you said are starkly different about the aspect of the budget today?

Dr. Elmendorf. Today, and in the future. Yes, even more so in the future.

Senator Kerry. But isn't it accurate that we have balanced the budget I think since World War II five times, and that each time we have balanced the budget, revenues have been somewhere between 19 and 21 plus percent of GDP? Is that accurate?

Dr. Elmendorf. That sounds right, Senator. I have

not checked exactly.

Senator Kerry. And assuming that is accurate, we are currently at 15 percent, 15.3 I think is your prediction for this year, of revenues to GDP. Correct?

Dr. Elmendorf. Yes. That is right.

Senator Kerry. So isn't it fair to say that, in fact, there is an aspect about our budget today that is starkly different, which is the level of revenues relative to GDP. It is starkly different, isn't it?

Dr. Elmendorf. Yes. That is right, Senator.

Senator Kerry. And it is starkly different in that it is well lower than the historical average of when we balanced the budget or not balanced the budget?

Dr. Elmendorf. Yes. That is right.

Senator Kerry. So let me ask you, given that reality and given the reality that you and others -- I think last year, the Committee on Fiscal Future of the United States, which was a joint effort of the National Academy of Sciences and the National Academy of Public Administration -- developed four budget scenarios.

They had one budget scenario where you had nothing but cuts, another budget scenario where you had nothing but tax

increase, and then two in between. The only way they could keep the revenues at the historical average and keep the spending at a decent level was basically with cuts. But that doesn't get you where you need to go in terms of some of this historical average and not winding up with major, major cuts in terms of the benefits of Medicare or Medicaid.

So if you want to avoid -- you made the statement to us a moment ago that we have to make a decision about what we want to do. Most people have accepted that we don't want to have major reductions to -- we have reforms, yes. We need to do a better job of making them fiscally sound. But I haven't heard anybody stand up on either side of the aisle and say there ought to be huge cuts in benefits.

If that is true, then aren't we forced into a situation where we look somewhere near the historical norm with respect to the revenue to GDP percentage?

Dr. Elmendorf. So if one wants to leave spending on Social Security and the major healthcare programs roughly in line with what would happen under current law, then one needs to either further carve away at all the other functions of the Government, or one needs to raise revenues above their historical average share of GDP by a significant

amount, or one could do combinations of those.

But there is no way to simultaneously let Social Security and the major healthcare programs grow the way they would under current policies or anything close to that and operate the rest of the Federal Government in line with its role in the economy over the past 40 years and keep revenues the same share of GDP they have been on average in the past 40 years. And the reason those things are inconsistent, even though they worked in the past 40 years, is because the number of people who will be older and the number who will be -- and the amount they will be collecting in health benefits will be so much larger in the future than in the past.

Senator Kerry. Well, I happen to agree with that judgment that you have made, and I think it is a very important one with respect to how we approach this.

I also want to -- we are going to obviously have some time here to discuss the healthcare piece, but isn't it true that, well, the Medicare excess cost growth, how does that compare to the excess cost growth in overall healthcare spending over the next decade?

I think in recent estimates that you found that

Medicare in the excess cost growth was actually lower than the historical average now. Isn't that true?

Dr. Elmendorf. Yes. So excess cost growth, meaning not necessarily excessive in the judgmental sense, but just faster growth in benefits per person than in the growth of GDP per person, that sort of excess cost growth in Medicare under current law is pretty close to zero for the coming decade. That would be a very sharp change from the experience of the past 40 years.

Senator Kerry. And what do --

Dr. Elmendorf. In relation to the discussion we had earlier about payment rates to providers.

Senator Kerry. So what do we attribute that significant reduction in the Medicare cost growth rate?

Dr. Elmendorf. So importantly, to features of the law, like the cuts in payment rates to physicians due to take effect the end of this year and like a number of the other cuts to provider payments enacted in last year's major health legislation.

Senator Kerry. So that has had a beneficial effect in terms of restraining growth in Medicare -- in Medicare cost?

Dr. Elmendorf. Yes. That is right.

Senator Kerry. Thank you. I will reserve my time at this point.

Co-Chair Murray. Representative Camp?

Mr. Camp. Well, thank you.

Director Elmendorf, I am sure you remember, as last year you testified before the President's National Commission on Fiscal Responsibility and Reform on a topic very similar to what you are covering today. It seems as if your presentation then said, then and now, that we need to get control of the automatic spending increases that have been built into the Government's budget. Is that a fair statement of your testimony then and now?

Dr. Elmendorf. Well, again, I think we said that those pieces are growing very rapidly and that to accommodate that, as it stands, would require very large changes in other aspects of the money the Government spends or collects.

Mr. Camp. Those are the significant drivers of our current situation.

Dr. Elmendorf. Yes.

Mr. Camp. So what programs in particular are at the core of CBO's projections for the long-term Government

spending? And which programs are responsible for the largest increases in Government spending?

Dr. Elmendorf. So if one looks at Figure 12 from the written testimony on page 39, and coming up on the screen for those with very good eyesight, one can see that this picture shows growth over the next decade in Social Security and in Medicare and in other major healthcare programs.

Mr. Camp. Do the other major healthcare programs include all of the Healthcare Act, long-term care and other Medicaid increases?

Dr. Elmendorf. So the other major healthcare programs are Medicaid, the Children's Health Insurance Program, and subsidies through insurance exchanges, and some related smaller spending.

Mr. Camp. And the long-term care entitlement?

Dr. Elmendorf. The long-term care entitlement, as you recall, actually raises money for the Government in the first decade of its life. And I don't know if that has been netted out here or not. I don't think so, actually, Congressman.

But one can see from this picture that the largest increase as a share of GDP over the coming decade among

these three categories is the other major healthcare programs, followed by Social Security and Medicare.

Mr. Camp. All right.

Dr. Elmendorf. And that is principally, I think, because of a great increase in the number of beneficiaries from the expansions enacted last year and continued sharp increases in costs for beneficiaries in those programs.

Mr. Camp. In your prepared testimony before the President's commission, you also included a chart, which -- if we could pull that up now, and everyone has a copy of this chart at their desk in their packet -- which showed real GDP per capita under different economic conditions. You will notice under the alternative fiscal scenario, the line stops between 2025 and 2030.

And you explained then that that line stops because economic growth collapses and that it simply can't handle debt loads that high. Is that an accurate statement of what you testified before the President's commission?

Dr. Elmendorf. Yes. That is right. We have updated this picture in our long-term projections from this year. But similarly, Congressman, not at quite the same point, the amount of debt under this alternative scenario becomes so

large that our models don't know what to do with it.

I don't think the economy would actually get that far at all because the people in the economy will be looking ahead and foreseeing what is happening. I think, in fact, much more serious problems will come sooner than we show in these pictures.

Mr. Camp. And I think you said that the Government debt has become so high that you don't know what to do with it because private investment ceases to function and the economy ceases to function under that scenario. Is that correct?

Dr. Elmendorf. Ceases to function at some point. Again, I think that the freezing up would probably come sooner than we show in those pictures because of an anticipation of that problem.

Mr. Camp. And I think that analysis really does go along with what other analysts have said of the country's debt-to-GDP ratio when it exceeds 90 percent, and I am talking total debt to GDP ratio, that it reduces economic growth, as others have said in their time, by about 1 percent at that level.

Dr. Elmendorf. Yes. I think the models that we are

using here are consistent with a consensus approach to estimating this sort of issue.

Mr. Camp. And am I correct to say that our total debt-to-GDP ratio is over 90 percent at this time?

Dr. Elmendorf. Yes. I think that is right, Congressman.

Mr. Camp. And what impact do you think these massive levels of debt relative to GDP have on the economy in general and specifically on the prospects for job creation?

Dr. Elmendorf. Those levels of debt are a burden on the economy. They reduce our output and our incomes relative to what we would enjoy if we had done less borrowing and had done more saving.

Mr. Camp. This committee has been tasked under the Budget Control Act with finding \$1.5 trillion in deficit reduction over a 10-year period. What is the size of the economy over the next 10 years?

Dr. Elmendorf. So GDP today is about \$15 trillion. We think it grows over the course of the coming 10 years. If you have done that calculation, Congressman, I would be happy to hear the number from you.

Mr. Camp. Well, just assuming over 10 years, \$150

trillion, we are talking about 1 percent of our economy, are we not, in terms of rough numbers?

And the reason I want to point out this number is you mentioned the impact of us making decisions about spending that might have impacts on the economy, and I just want to put in perspective, over the next 10 years, these reductions in debt that we are asked to find over the next 10 years roughly represent about 1 percent of the economy. And I am talking very rough numbers.

Dr. Elmendorf. So I think that sounds about right to me, Congressman. And I agree that the problem is very large by the standards of the incremental fiscal policy decisions that the Congress normally makes. But it should not be viewed as unsolvable. Changes in policy can put us on a different path.

Mr. Camp. And in terms of outlays, I think this amount over the next 10 years represents about 3 percent of our outlays, and as I think Senator Portman mentioned as well. And so, I think we need to put it in perspective that while I am not underplaying how difficult this might be, but in terms of impacting the economic trajectory of the United States economy, we are not over the next 10-year period in

significant percentages of either economy or outlays. Most families and businesses have had to do with less than 3 percent, and I think it is something over a 10-year period, they have obviously had to do with less than that.

Dr. Elmendorf. Yes.

Mr. Camp. And just lastly, I realize my time has expired. I do want to just ask you one quick thing.

We may come to agreement on impacts within the 10-year budget window, but we may have decisions that are outside of the 10-year budget window. And I just wanted to ask if you would be willing to work with us to find ways to measure the impact of policies outside the traditional budget window and if you would commit to helping us do that?

Dr. Elmendorf. Yes. Absolutely, Congressman.

Mr. Camp. Thank you very much, and I yield back.

Co-Chair Murray. Representative Van Hollen?

Mr. Van Hollen. Thank you, Madam Chairman.

Let me just start, Dr. Elmendorf, by thanking you for your testimony and just say that -- and this goes for Republicans and Democrats alike -- we are all entitled to our own opinions, but not to our own facts. And the last time that our budget was balanced was back in the 2001, 2000

time period. And in fact, during that time, revenues as a percent of GDP was 20.6 percent in the year 2000 and 19.5 percent in the year 2001.

And the last time spending was 18 percent of GDP was about 1967, and it has risen since then largely because we, as a nation, decided to make sure that older Americans in their retirement had the health security they needed. So it is important to keep those facts in mind as we go forward.

Now you posed a very fundamental question to this committee, and let me ask you this. If we were to try and continue with current retirement and healthcare, security programs in the future, we would need significant changes to revenue beyond current law, would we not, in order to fund them and balance our budget, assuming we kept the rest of Government constant?

Dr. Elmendorf. Yes. That is right, Congressman.

Mr. Van Hollen. And if we were to try to preserve those -- let me ask you this. If we were to continue current revenue policy without any changes, it would require very deep cuts to those retirement and security programs, would it not, if we were to try and bring down the deficit?

Dr. Elmendorf. If you also maintain the rest of the

Government in accordance with its historical pattern, yes, Congressman.

Mr. Van Hollen. That is right. And as you pointed out in your testimony, in fact, over the next 10 years as a percent of GDP, that is going down, is it not?

Dr. Elmendorf. Yes.

Mr. Van Hollen. Okay. So that is the fundamental question, and I think we recognize that we have to deal with the outyear issues. We have a demographic challenge. We have more and more people retiring. But as you just pointed out, if we want to avoid huge cuts to Medicare and to Social Security, we also have to deal with the revenue piece. In other words, we have to increase revenues beyond current policy if we want to avoid very deep cuts.

So I think it is important that we look at the revenue side of the equation right now, and you have presented that to us in your testimony. And I think it is time for this committee to get real and recognize that, yes, there are spending issues, especially in the outyears, but there is also a revenue issue.

Now, as you point out, under current law, the 10-year cumulative deficit is \$3.4 trillion. Correct? Under

current law.

Dr. Elmendorf. I think it is a \$3.5 trillion.

Mr. Van Hollen. Three and a half trillion dollars?

Dr. Elmendorf. Yes.

Mr. Van Hollen. And as you point out on page 19 of your testimony, if we continue current tax policy and the current physician payments under Medicare, that will rise from \$3.4 trillion to over \$8.5 trillion. That is there in your testimony.

Dr. Elmendorf. Yes.

Mr. Van Hollen. Now you mentioned those two factors together, but I think it is important to point out that of that over \$5 trillion, that the huge bulk of it has to do with continuing current tax policy, does it not?

Dr. Elmendorf. Yes.

Mr. Van Hollen. And in fact, by my calculation, you get just under \$4 trillion on revenue. And if you add the debt service associated with that, you are talking about \$4.5 trillion of your \$5 trillion dealing with current revenue policy. Is that right?

Dr. Elmendorf. Yes. That is right.

Mr. Van Hollen. So, just to be clear, if this

committee were to adjourn today and the Congress were to adjourn for the next 10 years and go away, we would actually achieve greater deficit reduction than if we went, took the Simpson-Bowles advice and went big. Is that not right?

In other words, we would get over \$4 trillion over that 10-year period, even if we fixed the doctor, physician reimbursement piece, right?

Dr. Elmendorf. So if -- let me make sure I have this right. If you extended those expiring tax provisions --

Mr. Van Hollen. That is right.

Dr. Elmendorf. -- and indexed the AMT for inflation -

-

Mr. Van Hollen. Yes.

Dr. Elmendorf. -- then that would add to deficits by \$4.5 trillion or so. That would be larger than the amount of savings if this committee stayed --

Mr. Van Hollen. It is simple math, right? It would be more than the \$4 trillion that a lot of people talked about, right?

Dr. Elmendorf. Yes. That is right.

Mr. Van Hollen. Okay. So I think it is important, as we look at this challenge, to look at both sides of the

equation there. And what we are talking about, just so we can translate this into what the American people have experienced, what we would be talking about is essentially going back to the same tax rates and tax policy that was in effect during the Clinton administration, a period of time when 20 million jobs were created and the economy booming.

Now I am not suggesting we go back to that particular tax policy, but if you look at Simpson-Bowles compared to current law, they provide about a \$2 trillion tax cut compared to current law, as opposed to \$4 trillion. If you look at Rivlin-Domenici, they propose about a \$1 trillion tax cut compared to current law, approximation.

So if we are really going to address this challenge, let's recognize that if we don't deal with the revenue piece, as Dr. Elmendorf said, you are talking about dramatic cuts to health and retirement security for America's seniors. We have got to take a balanced approach. That is why the other bipartisan groups took that kind of approach.

Thank you, Madam Chairman.

Co-Chair Murray. Senator Toomey?

Senator Toomey. Thank you, Madam Chairman.

Since my colleagues have raised this issue, I just

want to touch on a couple of things that didn't quite make it into the conversation so far. Isn't it true that as recently as 2007 the current tax rate structure yielded revenue that was about 18.5 percent of GDP?

Dr. Elmendorf. I think that is right, Senator. Yes. The current level, of course, is very low because the economy is very weak.

Senator Toomey. Exactly. And the main reason that total revenue as a percentage of GDP is so much lower than the historical levels is because we have an economy that is still effectively in a recession, very high unemployment, very weak, lack of growth. Isn't that right?

Dr. Elmendorf. Yes. That is right.

Senator Toomey. And as recently as 2007, the deficit that we had that year was about, if I remember correctly, less than 1.5 percent of GDP, I believe. And if we could get to the point where we consistently had deficits of 1.5 percent of GDP, then our debt as a percentage of our economy would clearly be declining, and we would have, to a very large extent, solved this problem, if not completely.

Dr. Elmendorf. Yes. That is right. If you could -- yes. That is right.

Senator Toomey. To the level of the deficit that we had in 2007, with the current tax rates. Let me ask a couple of other questions, if I could?

You went through, and I don't think there is any dispute that excessive debt has all kinds of negative implications -- we all acknowledge that -- including the possibility that we get to the point where you have a financial crisis, an economic freezing up.

Isn't it true that it is essentially impossible to know precisely when you get to that point?

Dr. Elmendorf. Absolutely.

Senator Toomey. So it is just not knowable?

Dr. Elmendorf. I think it is just not knowable.

Senator Toomey. Right. Isn't there a danger that the magnitude of the debt is already impeding economic growth, having a chilling effect on investment and risk taking? Isn't that possible?

Dr. Elmendorf. I think the level of debt is probably weighing on economic activity. All things equal, of course, we wish we had less.

Senator Toomey. Right.

Dr. Elmendorf. I think the question is how to proceed

from here.

Senator Toomey. I guess the point I want to make is given that it is probably already weighing on economic growth and given that we acknowledge that continuing down this path eventually leads to a full-blown crisis and we can't know when, that suggests to me that it is very dangerous to delay making meaningful reform. And while there is some concern that curbing the size of the deficit in the short run impedes economic growth, I would argue that it is already happening.

And if we -- if the future promised reductions in the deficit either weren't credible or at some point became less credible, then we could discover we are already in that territory where the financial crisis could emerge. Isn't that a danger that we would run in delaying this?

Dr. Elmendorf. I think there are disadvantages to delay, Senator, as we said in the written testimony and as I repeated here. Again, based on our analysis, which I think is consistent with a consensus of professional opinion, immediate increases in taxes or cuts in spending would slow the economic recovery. But that is not meant to imply that there aren't a variety of factors that can matter in

different ways, not meant to imply that we are sure we have that right.

But that is, I think, the consensus of professional opinion.

Senator Toomey. It might be, but there certainly is an alternative point of view about that, especially with regard to the spending side.

Dr. Elmendorf. Yes, Senator. That is right.

Senator Toomey. And even though you and I might disagree on this debate somewhat, I am sure you would agree that when it comes to its impact on economic growth, not all Government spending is equal.

Dr. Elmendorf. That is absolutely right.

Senator Toomey. Spending in your models would generate more rather than less. Similarly, not all tax cuts are comparable, right?

Dr. Elmendorf. Exactly.

Senator Toomey. Some encourage economic growth more than others?

Dr. Elmendorf. Exactly.

Senator Toomey. And in fact, crudely speaking and broadly speaking, that spending and tax cuts, while they may

arithmetically have the same impact on the deficit if you assume they have no other implications, in fact, they do have other implications?

Dr. Elmendorf. That is right. And when we do economic modeling of the consequences of alternative fiscal policies, we try to capture that. We incorporate the level of marginal tax rates on labor and capital and those effects on work and on saving.

Senator Toomey. Right. And on page 33 of your testimony, you observe that lower marginal rates enhance the incentive to work and save and invest, and that has a pro-growth feedback on the economy.

One of the things we haven't discussed, but I would like your reflection on, is the possibility of a revenue-neutral tax reform that simplifies the code, broadens the base, and lowers marginal rates. Wouldn't that tend to enhance growth and, therefore, enhance revenue to the Government?

Dr. Elmendorf. Yes. That is right, Senator. The magnitude of that effect, of course, depends on the specifics of the policies that would be enacted.

Senator Toomey. Right. And so, I wonder if you have

a rule of thumb that you could share with us. For instance, for a given incremental increase in the rate of growth on average, what kind of impact does that have on the deficit over an extended period of time?

Dr. Elmendorf. Well, so we offer our rules of thumb for that in the back of our annual Budget and Economic Outlooks. And the magnitude of that effect I will offer to you in one moment.

Senator Toomey. A figure that comes to mind, and maybe you could confirm or refute, is that a 0.1 percent of additional growth on average sustained over 10 years is roughly \$300 billion in additional revenue? Is that about -

Dr. Elmendorf. Yes. That is just right.

Senator Toomey. So a full percent, I mean, this may not be perfectly linear, but it certainly goes in the same direction?

Dr. Elmendorf. Yes. It almost certainly isn't perfectly linear, and we offer these rules of thumb for small changes because we are just not sure what else might happen with very large --

Senator Toomey. The point is a small, sustained

change in growth has a huge impact on the deficit or reducing the deficit. Would you agree with that?

Dr. Elmendorf. Yes. That is right.

Senator Toomey. Thank you.

Thank you, Madam Chairman.

Co-Chair Murray. I thank you very much. And we have gotten through our first round here, and I appreciate everybody keeping it concise.

I am going to have to use the prerogative of my chair to make a small change at this time. The House is going to be having votes at approximately 1:00 p.m. There are 12 of us, and the time is very short. So unless somebody throws something at me, I am going to limit each of us to 2 minutes in the final round and would ask everybody to please keep it to that timeframe.

Dr. Elmendorf, let me just ask, as you have been talking about, in the long-term budget report from January, CBO included an analysis on the impact of lower than expected economic growth on the Federal budget. I wanted to ask you, what does CBO estimate is the impact on the deficit projections in the near term and over the next 10 years if GDP growth continues to weaken beyond what is reflected in

the current estimates?

Dr. Elmendorf. So, certainly, a weaker economy implies worse budget outcomes, primarily because tax revenues fall. Also because there is some extra spending in some of the entitlement programs that we talked about a moment ago.

We have not done quantitative estimates of budget outcomes for other particular scenarios beyond what is in these rules of thumb that we have offered in our volume in January. And the rules of thumb are rough because a lot of things can or may not rise and fall with the rest of the economy.

We have been surprised in the past few years at some of the outcomes of tax revenue even given the state of the economy. But there is no doubt that a weaker economy is worse for the budget and a stronger economy is a lot better for the budget. The challenge is how to move the economy, and it is not easy to move a \$15 trillion economy.

Co-Chair Murray. Thank you.

I do have a question about sequestration. I am going to submit it for the record because I do think it is important. As hard as the choices we are looking at here,

we need to understand the impact of that, and I appreciate the information you have put out on that.

But the significant impacts to sequestration I think need to be understood by our committee as well. So I will submit that for the record.

Dr. Elmendorf. I will be happy to answer it, Senator.

[The information follows:]

Co-Chair Murray. And reserve my time and turn it over to Mr. Hensarling.

Co-Chair Hensarling. Dr. Elmendorf, I think it was Senator Kerry who brought up that revenues today are roughly at 14 percent of GDP. Doesn't your latest budget estimate under a current policy baseline show that revenues go back to their historic norm of 18 percent of GDP in 2014?

Dr. Elmendorf. Yes. That is right, Congressman. They are a little over 15 percent today, and the improvement in the economy and other underlying factors in the tax code we think will push that up to a little over 18 percent under current policy.

Co-Chair Hensarling. Your alternative fiscal scenario, which is a current policy baseline, also shows spending going from a historic average of roughly 20.5 percent up to 34 percent of GDP. Is that correct?

Dr. Elmendorf. That sounds about right, Congressman.

Co-Chair Hensarling. So is it fair to say that with respect to revenues, one is episodic related to the lack of economic recovery, the other is structural. Is that a fair assessment?

Dr. Elmendorf. Yes. Both factors are at work right

now, Congressman, and --

Co-Chair Hensarling. Let me continue on there. Those who have advocated or have brought up that historically when the budget has been balanced, taxes have gone beyond their historic norm of roughly 18 percent of GDP to closer to 20 percent of GDP. And again, this is your alternative fiscal scenario shows that spending by 2035 goes up to 33.9 percent, and the same alternative fiscal scenario shows that taxes already on a path to increase from 18 percent of GDP to 18.4.

So following the analysis of those who advocate that in order to achieve a balanced budget that revenues have to come up from what you say they are already rising, from 18.4 to, say, 20 percent of GDP, wouldn't the analysis suggest under a balanced approach that spending has to decrease essentially 14 percentage points under your alternative fiscal scenario to reach its historic norm?

Dr. Elmendorf. So, Congressman, I would rather not parse the meaning of the word "balance," given its role, apparent role in your discussions. But you are right that if revenues were at 20 percent of GDP, then balancing the budget, given the assumptions, it would require a reduction

in spending.

Co-Chair Hensarling. Thank you.

Co-Chair Murray. Representative Becerra?

Mr. Becerra. Dr. Elmendorf, I think I am going to start calling you "Sergeant Friday." You are here essentially giving us at least your best interpretation of the facts, and we appreciate that because you are not trying to give us opinion. You are not telling us whether in 5 years or 10 years we should reduce the benefits we give to seniors under Medicare or make a change to our defense and security needs.

You are simply telling us what the numbers show and leaving it to us as policymakers to come up with a good mix. And I appreciate that. I suspect your mother or father or your grandmother or grandfather are probably also pleased that you are just talking numbers and not saying what should be done to them with regard to Medicare or Social Security or anything else.

One quick point, with regard to the discussion of our long-term costs, you mentioned Medicare and Social Security and Medicaid. Medicare and Medicaid, because they deal with healthcare and healthcare costs, are in a different boat

than Social Security, are they not, in terms of their long-term costs?

Dr. Elmendorf. Yes. That is right. The increases in spending for those programs that we project under current law are a lot greater over time than for Social Security.

Mr. Becerra. And indeed, Social Security, by about 2028, 2030, starts to stabilize and stays pretty constant in terms of its cost to the Federal Government into the outyears, right?

Dr. Elmendorf. Yes. Roughly so. After the baby boom generation has primarily retired, that line roughly levels out.

Mr. Becerra. And because you are dealing with facts, you are not here to tell us about how to make that fix to healthcare because the reality is that Medicare and Medicaid are simply reimbursement or financing systems. If we were to just cut benefits for a senior, that doesn't necessarily mean that their healthcare cost will drop. That shifts the cost more into the pocket of the senior to pay for that care if Medicare just reduces what it reimburses?

Dr. Elmendorf. I think it depends on the policy, of course. But there are some policies that shift cost, and

there may be some policies that reduce overall costs.

Mr. Becerra. Thanks, Sergeant Friday. Appreciate it.

Dr. Elmendorf. Thank you, Congressman.

Co-Chair Murray. Senator Kyl?

Senator Kyl. Thank you, Dr. Elmendorf.

Just one question in the interest of time here. While I know you agreed with Senator Toomey's observation that there is another point of view or other points of view, regarding your argument that cuts in spending now can harm economic growth or delay economic recovery, that is true of defense spending as much as other spending. Is that not correct?

Dr. Elmendorf. It is true of potentially all types of spending. There may be differences across types, but I think that is a more subtle distinction.

Senator Kyl. Yes. And here, with defense, for example, you have got high unemployment of returning veterans to begin with. You have the reduction in end strength. You have got more people potentially unemployed. You have got people making radios and building ships and so on. And if those cuts, therefore, end up reducing the employment in those industries and the amount of money spent

in those areas, obviously, it could delay economic recovery.

Dr. Elmendorf. Yes. That is right, Senator.

Senator Kyl. Thank you.

Co-Chair Murray. Senator Baucus?

Senator Baucus. Thank you, Madam Chairman.

I wondered, Dr. Elmendorf, if you could just again, we discussed a little bit of it already, what changes either let's say in tax policy will stimulate the economy most, if you could rank them somehow?

Dr. Elmendorf. Well, as it turns out, in the table which you are looking, Senator, from our January 2010 report, we did consider the effects of a set of alternative tax cuts. We have not updated this table since that point. If we did, I think the numbers would be slightly different, but probably not fundamentally different.

Reductions in payroll taxes that we studied here were among the more powerful levers, followed by expensing of investment costs, and then followed below that by a little bit by broader reductions in income taxes. And the reason for that difference is principally that the money that is saved by employers or employees in payroll taxes we think translates into a fairly comparatively large amount of

incremental spending. And also in the case of a cut to what employers pay amounts to at least a temporary discount on the cost of hiring workers.

Senator Baucus. Let me change subjects. If we have a revenue-neutral tax reform, corporate or individual, and the tax reform, let's say, on the individual side is dramatic, broaden the base, lowering the rate, et cetera, how much growth would result from a very simplified tax code along those lines?

Dr. Elmendorf. A tax code with a broader base and lower rates would spur economic growth, but the magnitude is something we would have to take specific proposals from you back to our models and work hard on them for a while before we could hazard any sort of quantitative estimate.

Senator Baucus. Okay. Thank you.

Dr. Elmendorf. Thank you, Senator.

Co-Chair Murray. Representative Upton?

Mr. Upton. Thank you.

I am concerned about the impact of the Affordable Care Act on job creation. Can you provide us a detailed explanation of the methodology used to calculate how many employers will actually drop their healthcare coverage for

their employees?

Dr. Elmendorf. I can provide a brief summary in the next minute and three-quarters, Congressman. We have a model of health insurance coverage in which employees and employers are trying to obtain coverage at low cost, but also giving weight to the quality of the coverage they receive.

In our analysis, the Affordable Care Act encourages some employers to provide insurance coverage who would not have otherwise because of the mandate for insurance coverage and some of the subsidies. On the other hand, it encourages other employers who would have offered coverage not to offer any more. And we think that latter effect outweighs the former, and we have a small reduction in employer-sponsored insurance coverage.

Our estimates are very consistent with the estimates of other people, with large-scale models like those at the Urban Institute. Obviously, there is a tremendous amount of uncertainty around those estimates, and there have been some surveys that have suggested there would be more employer dropping.

At this point, based on the things that we have seen

since we did those estimates, we are comfortable those estimates make sense. But it is an issue where we have been asked to explore the sensitivity of the budgetary effects to alternative outcomes in terms of employer-sponsored insurance coverage, and we are working on those estimates now.

Mr. Upton. Could you actually provide us maybe a dial-up? I don't know what your percentage is. I thought it was like as low as 5 percent or less?

Dr. Elmendorf. It is a small percentage. I am not exactly sure.

Mr. Upton. Yes. And I wonder if you could provide us an estimate, if it was maybe 10 or 20 percent?

Dr. Elmendorf. So the challenge we have is that it matters a lot for budgetary cost who ends up with and without employer-sponsored health insurance coverage. So we can't really do just a scaling up in that sense. We have to understand in the model, and there are ways to change the assumptions in the model to give different answers. But we need to do that because that will affect the budgetary cost.

It is also not obvious that the budgetary cost is as large as it may seem at first. If people are not getting

employer-sponsored coverage and move to the exchanges, they will pay -- the Government will pay more for their coverage. On the other hand, the employers will have extra money that they were previously using to buy health insurance with. Most economists think that money will turn up as wages for workers. They will pay taxes on that.

If it doesn't, it will turn up as additional corporate profits, and they will pay tax on that. So the overall budgetary effects will depend on the combination of changes in exchange subsidies, in Medicaid costs, and in tax receipts. But we are working on that, Congressman.

Mr. Upton. Thank you.

Co-Chair Murray. Thank you.

Representative Clyburn?

Mr. Clyburn. Thank you, Madam Chair.

Dr. Elmendorf, let me look at revenue from a different perspective here. Is it fair to say that the decrease -- or the increase in unemployment has decreased revenue going into the Federal coffers?

Dr. Elmendorf. Yes. That is right, Congressman.

Mr. Clyburn. If we had a decrease in unemployment of just, say, 0.5 percent -- from 9.1 to 8.6 -- what would be

the level of revenue increase?

Dr. Elmendorf. I can't do that in my head, Congressman. It would help, but I don't know. And it would help partly because we would pay less unemployment insurance benefits and partly because of people who are earning money would pay taxes on those earnings.

Mr. Clyburn. So it is a double whammy.

Dr. Elmendorf. Both sides of the budget would be affected.

Mr. Clyburn. I would like to see some computer printout.

Dr. Elmendorf. I will task my computer with that assignment, Congressman.

[The information follows:]

Mr. Clyburn. I appreciate it. Thank you.

Co-Chair Murray. Senator Portman?

Senator Portman. I think Congressman Clyburn has just made a great point, which is the economy plays such a huge role here. And since this is a hearing about the history of how we got here, I have gone back and looked at your May 12, 2011, report, which talked about earlier 32 percent of the difference between a \$5.6 trillion surplus projected and the \$6.2 trillion deficit, which is an \$11.8 trillion swing, 32 percent of that is because of the economy.

And about 33 percent of it is new spending. About a third of that spending is for global war on terror -- Iraq, Afghanistan, and other spending on the war on terror. It is about 39 percent is due to new spending when you add the 6 percent that is the stimulus.

Fifteen percent is the Bush tax cut. By the way, over 70 percent of that went to those making less than \$250,000 a year. And then the rest is interest and the AMT and the rebates in 2008.

So I think it is a great point that the economy is going to drive so much of this. And we talked about this earlier, but you said that you thought that increasing taxes

at this point would have a negative impact, just as you thought that certain spending cuts would have a negative impact on economic growth and jobs.

But then, in response to Senator Baucus, you said that some tax reform, particularly lowering the rates, broadening the base, would have a positive economic impact. Can you briefly speak to that as it relates to the corporate tax code and the possibility also of lowering the rate to make the U.S. more competitive?

Dr. Elmendorf. So I think that in terms of both the individual income tax and the corporate income tax, economists widely agree that lower tax rates and broader base would be good for the economy both because the lower rates would reduce the disincentive to worker to save and also because broadening the base itself can, if done in certain ways, reduce the incentives for misallocating capital resources.

Again, to actually estimate the effects on the economy, we or our colleagues at the staff of the Joint Committee on Taxation would need to have specific proposals and would need to spend some time trying to model those. It is a very complicated business, as you know, Senator.

Senator Portman. How long would it take you?

Dr. Elmendorf. I will not commit to that. Offhand, if we have proposals from you, we will work on them as fast as we possibly can. I will certainly promise you that.

Senator Portman. And prioritize them, right?

Dr. Elmendorf. We are giving very high priority to the work of this committee, Senator.

Senator Portman. Thank you, Madam Chair.

Co-Chair Murray. Senator Kerry?

Senator Kerry. There is a big distinction, is there not, almost obvious, Dr. Elmendorf, if 98 percent of America was getting a tax cut and 2 percent, who happen to be the wealthiest people whose decisions are very different and whose impact on the economy is very different, there is a big difference in that versus sort of a blanket discussion of all of the tax cut versus none. Correct?

Dr. Elmendorf. In terms of the economic effects, yes, Senator.

Senator Kerry. Yes.

Dr. Elmendorf. We think that is right.

Senator Kerry. And I think that is part of the modeling that needs to be done here because I think that

distinction will be very telling in a lot of ways.

What I want to ask is I think it would be helpful to all of us on the committee, I have great respect for the Rogoff-Reinhart analysis. In fact, I suggested we might get them in here, and I think it is an important one. But, and here is the "but," and I would like you to draw the distinction for us.

Your analyses and much of our discussion centers around the public debt. The public debt is 62 percent, I believe, of GDP. But we have had a number of references here to the gross debt, which obviously includes all of the trust funds and so forth, where there is a very different impact because of the full faith and credit of the United States and printing and so forth.

Help us understand how that distinction might play out in our deliberations, particularly with respect to the impact on interest rates. I think the public debt has far more impact on interest rates than on the economic judgments, does it not? So maybe you can just educate us a little bit on that distinction between them.

Dr. Elmendorf. Yes, Senator. So CBO focuses on debt held by the public because we think that is a better measure

of the impact of Federal borrowing on financial markets today than gross debt. Of course, any snapshot of what the Government owes at a point in time will be very incomplete without looking at where the fiscal trajectory is going, and that is why we always combine our reporting on current levels of debt held by the public with projections of revenues and spending. And certainly, financial markets are very attentive not just to the current amount of debt, but also to the amount of debt they would expect the Government to be trying to get them to buy in years ahead.

But our view is that debt held by the public, together with these projections for the future, offers you and your colleagues a fairly complete, by no means perfect, but a fairly complete picture of the Federal budget situation.

Gross debt, which, as you said, includes money, includes bonds held by various Government trust funds, we think does not really measure the amount of -- does not measure the amount of debt that the private financial system has been asked to absorb today, nor is it a very good measure of what will happen in the future because for some programs, the amount of debt held in those trust funds is a lot less than the amount that they will need to pay benefits

under current law. In other cases, the amount of debt held in the trust funds doesn't actually correspond to future spending. So we just don't think that is the most useful measure.

Now in the work that Carmen Reinhart and Ken Rogoff did, they viewed that as the best available measure for the set of countries over the period of time that they have done this analysis for. And I don't want to put words in their mouth, but we have discussed this issue with Carmen.

And, but I think in our case, because we do these very elaborate projections on a very detailed level of the budget, that combining those projections with debt held by the public gives you and your colleagues the best sense of where this country stands today.

Senator Kerry. Thank you.

Co-Chair Murray. And Representative Camp?

Mr. Camp. Thank you very much.

I just wanted to point out that as part of the fiscal commission, I researched how often Federal revenues exceeded 20 percent of GDP in the history of our country, and we found they have only done it three times since -- in the history of our country -- in 1944, in 1945, and 2000.

And in 2000, they were 20.6 percent of GDP revenues, and that was really largely due to the threefold increase in capital gains from \$40 billion in 1999 to \$12 billion -- or \$121 billion in 2000. So that was what drove that.

Is that and --

Dr. Elmendorf. I think that is right, Congressman.

Mr. Camp. Thank you.

And in the 11 fiscal years since 1940, we have had surplus revenues for 4 of those years between 19 and 20 percent, and for 7 of those years, they were less than 19 percent of GDP.

So I have a letter that outlines all of this that I would like to submit for the record. And I just think it is important to point out that, again, during the 12 years in which the budget was in surplus, outlays never exceeded 19.4 percent of GDP, and I think it is important to keep those revenue levels in historical perspective.

So, without objection, I would like to submit that letter for the record.

[The information follows:]

Co-Chair Murray. Representative Van Hollen?

Mr. Van Hollen. Thank you, Madam Chairman.

I would again point out that the last time Federal spending was around 18 percent of GDP or lower was about 1967. We made a decision in this country to provide for health security for seniors. So we have really got to look at that period of time since then if we want to continue that commitment, including what years the budget was in balance, which was in 2000-2001 period.

Look, Dr. Elmendorf, I think you have made a very good point in your testimony. I know you are not making recommendations, but I think your testimony was clear that you can't address the deficit challenge without modernizing the health security programs, unless you have large increases in taxes above even current law. But unless you change current tax policy, you can't address the deficit situation without deep cuts in health security programs.

Now I just want to have a quick question. You mentioned that there are some tax policies that generate more economic activity, some that generate less. You mentioned the payroll tax holiday is one that generated relatively more than some of the others because more money

in people's pockets.

Isn't it also true that with respect to spending programs, there are some that generate more activity than others in the economy and that investments in the area of infrastructure and education provide for economic growth? Isn't that also the case?

Dr. Elmendorf. Yes. But just give me one moment to say that I want to be careful about the pieces of the budget. There are revenues. There is Social Security and the major healthcare programs on my chart, and there is the rest of the budget. And I don't think you disagree with this, Congressman.

But the thing that is not possible to do is to maintain Social Security and the major healthcare programs in their current state and maintain the rest of the Federal Government at the same share relative to the size of the economy it has been in the past and maintain revenues at their historical average share of GDP.

Mr. Van Hollen. Right.

Dr. Elmendorf. One needs to move at least one. One could also choose to move any two or three of those as you choose. What is not possible, as a matter of arithmetic,

given the aging of population and rising healthcare costs, is to have all three of those pieces look like they looked historically.

And different policies on the spending side do have different effects in economic growth, and they do at different horizons. So some policies might be more effective this year or next. Others might be more effective over longer periods of time, and we can try to provide that sort of information to you and others if you are interested in that.

Mr. Van Hollen. I appreciate that, Dr. Elmendorf. I am just making the point that both tax policies, as well as investment, spending policies, both can have positive economic impact. Is that right?

Dr. Elmendorf. Yes. That is right.

Mr. Van Hollen. Thank you.

Co-Chair Murray. Senator Toomey?

Senator Toomey. Thanks, Madam Chairman.

Dr. Elmendorf, one of the challenges that we face is how we can address these challenges in a credible way, right? How, for instance, willing will future Congresses be to abide by spending caps or other kinds of reductions or

disciplines that we might try to impose? And of course, we cannot tie the hands of future Congresses.

So I wonder if you might reflect on ways that we could maximize the chances that future -- that spending restraints that we would hope to achieve would, in fact, come to pass, whether that would be through strengthening existing budget enforcement mechanisms, creating new ones, or other ways that we might do that.

Dr. Elmendorf. I think, Senator, the most effective way to ensure that changes you discuss today actually become -- take effect later is to enact those changes into law today. Enforcement procedures are only a backstop. Ultimately, the Congress will need to enact changes in the legislation governing certain programs or provisions to the tax code if it wants to make those changes.

And if specific changes are enacted into law this year, then I think there is a much greater chance that they will take effect when the time comes than if what is enacted into law this year is simply a set of objectives for total amounts of spending or total amounts of taxes or other sorts of benchmarks.

Senator Toomey. So structural reforms in a program

are likely to have more enduring results than long-term caps designated. Would you agree with that?

Dr. Elmendorf. Yes, I think that is right. And I think we have seen that historically. The original Gramm-Rudman legislation, Gramm-Rudman-Hollings, was cast aside because the overall target that it set for the deficit proved to be impossible to meet. Whereas the provisions of the early 1990s, the PAYGO provisions that tried to make it more difficult for the Congress to make deficits worse, seem, to most observers, to have been at least somewhat effective during the period when the Congress was very concerned about budget deficits.

So I think it is the important aspect of this for both the long-term effects and also for the shorter-term effects in terms of people believing the deficits will be smaller in the future comes from specificity in putting provisions into law today, even if they are timed to take effect, for various different reasons, at different points in the future.

Senator Toomey. Thank you.

Co-Chair Murray. Thank you very much.

I want to thank all of our committee members for being

so accommodating. Dr. Elmendorf, certainly, for your input and your staff's input for today as well.

I want to remind all of our members that they have 3 business days to submit questions for the record, and I hope that the witness can respond quickly to that.

Dr. Elmendorf. Yes, we will.

Co-Chair Murray. Great. Thank you.

And members should submit their questions by the close of business on Friday, September 16th.

[The information follows:]

Co-Chair Murray. Without objection, the joint committee stands now adjourned.

[Whereupon, at 1:10 p.m., the committee was adjourned.]