PERSPECTIVES ON LONG–TERM DEFICITS

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PERSPECTIVES ON LONG–TERM DEFICITS

THURSDAY, JANUARY 21, 2010

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

The committee met, pursuant to call, at 10:05 a.m., in room 210, Cannon House Office Building, Hon. John Spratt [chairman of the committee] presiding.

Present: Representatives Spratt, Schwartz, Kaptur, Doggett, Blumenauer, Berry, Boyd, McGovern, Tsongas, Etheridge, McCollum, DeLauro, Edwards, Scott, Larsen, Bishop, Connolly, Schrader, Ryan, Garrett, Diaz-Balart, Campbell, Jordan, Lummis, and Austria.

Chairman SPRATT. I call the hearing to order and welcome our witnesses and others in attendance.

A year ago, the economy was in free fall. In January alone, employers cut jobs by 741,000 employees. Americans had seen their retirement savings plunge by more than $2 trillion between the first quarter of 2008 and the first quarter of 2009. And central to today's hearing, the record surpluses that existed in January of 2001 were turned into record deficits for as far as the eye could see. This was a legacy of the Bush administration to the Obama administration and to this Congress.

While too many Americans continue to feel the pain of the recession, and we have much more work to be done if we are to rebuild our economy, it is clear that actions taken in the last year have pulled the economy back from the brink. GDP growth has turned from negative to positive. Job losses have steadily declined, and the value of retirement accounts have begun to recover. I believe the Dow went up two points yesterday alone.

Focusing first on rescuing the economy has meant that additional costs to the budget have been incurred necessarily. Indeed, it is counterproductive to try to balance the budget in the midst of a recession, and a rebuilt economy is critical to reducing deficits.

At the same time, the long-term budgetary situation that we are facing remains unsustainable. As the economy recovers, our focus must increasingly be on addressing the long-term fiscal challenges that we are facing, and that is why we are holding today's hearing.

Next week, we will get the official view of the Congressional Budget Office on the long-term budget and economic outlook. Today, we are fortunate to hear from a number of outside witnesses who have been working to define the nature of the long-term problem and to suggest possible approaches to addressing it.

I would like to welcome this morning John Podesta, CEO and founder of the Center for American Progress; Maya MacGuineas, president of the Committee for a Responsible Federal Budget; Bob Greenstein, founder and executive director of the Center on Budget and Policy Priorities; and James Capretta, who is a fellow at the Ethics and Public Policy Center.

We welcome you this morning and look forward to your testimony. But before I ask you to testify, let me ask our ranking member if he would care to make an opening statement himself.

Mr. RYAN. Thank you, Chairman.

First, I want to applaud you, Chairman, for choosing to begin this year's budget season by focusing on our Nation's deficit and debt. We are, after all, the Budget Committee.

Now, many of us here have warned for years about the unsustainable trajectory of Federal spending growth, particularly that of our largest entitlements, and what it means for America's economic and fiscal future. For a long time, these warnings seemed to fall on deaf ears, but there is a reason to think that might be changing.

Americans from all corners of our Nation have become increasingly alarmed and angered by the explosion of spending, deficits, and debt they have seen come out of Washington, and they have a right to be.

Consider: In a single year, this Congress has pushed through a trillion-dollar debt-financed economic stimulus, a budget that would double the debt in 5 years and triple it in 10 years, and initiated the expansion of government control of the Nation's energy sector, financial markets, and the auto industry. But I think Americans are most alarmed by the seemingly relentless drive to jam through a new trillion-dollar entitlement and a government takeover of our Nation's health-care sector.

All told, the Congress and the White House last year pushed through legislation that will boost spending, taxes, deficits, and debt by unrivaled numbers. As alarming as today's $1.4 trillion deficit is, our long-term debt projections are almost inconceivably worse.

This past November, historian Niall Ferguson wrote in Newsweek that if we fail to come up soon with a credible plan to get our fiscal house in order, quote, "The danger is very real that a debt crisis could lead to a major weakening of American power," end quote. And he pointed to historical precedents in which great empires collapsed under their indebtedness. We like to think this couldn't happen to us. But then we never thought General Motors would go bankrupt. We certainly never imagined that the Chinese would be lecturing us about fiscal prudence. But here we are.

We must set a different course. And I think that starts with recognizing a few basic points.

First, while it might be a great talking point for some, we didn't get to this point because the Federal Government was being starved by American taxpayers; we are here because Washington spends too much. Even if this Congress lets all of the 2001 and 2003 tax laws expire, throws people most onto the alternative minimum tax and resurrects the death tax, all it would accomplish is having imposed the largest tax increase in history in the midst of a recession because, according to CBO, Federal spending would still far outpace revenue.

Second, the greatest factor in Washington's spending problem is the unsustainable growth of our largest entitlements—we all know this to be true—specifically in Social Security, Medicare, and Medicaid. And for every year we put off addressing it, the problem gets significantly worse. We need real, substantive entitlement reform proposals. I have offered ideas of my own, and others have as well. But we need to move beyond the debate and get to the business of actually reforming these programs. What I hope we hear today from these very insightful and impressive witnesses is what kind of fundamental entitlement reform they recommend to get this problem under control.

And, with that, Chairman, thank you for having this hearing.

Chairman SPRATT. Mr. Ryan, before proceeding with the statements, let me ask unanimous consent that any Member who wishes to submit an opening statement may do so at this point.

Without objection, so ordered.

[The prepared statement of Mr. Connolly follows:]

PREPARED STATEMENT OF HON. GERALD E. CONNOLLY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. Chairman, thank you for holding this hearing on the impact of long-term budget deficits.

It is important to note that we did not invent the concept of a budget deficit. In fact, Congress, both Republican led and Democratic, has approved budgets in deficit in 74 of the past 100 years. Many on the other side of the aisle recently have taken the position that deficits are a bad thing, while simultaneously ignoring the significant contributions of their own actions to increase the national debt.

Presumably, they hope that by ignoring the causes, they can continue with the same, fiscally irresponsible actions. In fact, while $479 billion of the current deficit can be attributed to the worst recession since World War II, more than $670 billion of the deficit is a direct result of three Bush and Republican leadership policies: tax cuts that weren't paid for, a prescription drug plan that wasn't paid for, and two wars that weren't paid for. That is the fiscal legacy that we inherited, but now the responsibility for America's fiscal stability lies with us. Although we did not create the deficit, we have a moral responsibility to address long-term deficits.

Last year, under the leadership of Chairman Spratt, this Committee began a process that resulted in a Fiscal Year 2010 budget resolution that reduced the budget deficit by two-thirds over four years.

This past July, the House of Representatives voted to reinstitute statutory Pay-As-You-Go legislation. When originally adopted in 1990, PAYGO led to four straight years of budget surpluses under President Clinton, starting in Fiscal Year 1998—the first surpluses in 30 years. This year, 24 Republicans joined us in fiscal responsibility. Although just one Republican on this committee joined us in fiscal responsibility.

Moving forward, we must show that it is possible to have a reform agenda that is fiscally responsible. Without long-term fiscal responsibility, the prospect for long-term federal funding of worthwhile programs, especially Social Security and Medicare, dims.

Although we already have taken a number of positive actions, I believe we must go further. In December I voted against using repaid and unused TARP funds for expanding stimulus efforts. This vote was taken on the same day that we voted to increase the nation's statutory debt ceiling—a move required lest government be forced to shut down before the end of the year. The unspent and repaid TARP funds represent the single largest opportunity for deficit reduction in our nation's history, and I believe that we must avail ourselves of this powerful tool rather than turning strictly to further spending and deficit increases.

I look forward to the witnesses' testimony on how a renewed focus on long-term deficits can help ensure the long-term viability of essential government programs and operations.

Chairman SPRATT. I think the sensible way to proceed is from left to right, political and geographically, with Mr. Podesta.

Mr. PODESTA. I will take that as a compliment.

Chairman SPRATT. And let me say to you and all our witnesses, thank you for coming. We will make your statements part of the record so that you can summarize as you see fit.

The floor is yours.

STATEMENTS OF JOHN D. PODESTA, CEO, CENTER FOR AMERICAN PROGRESS; MAYA MACGUINEAS, PRESIDENT, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET; BOB GREENSTEIN, EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES; JAMES C. CAPRETTA, FELLOW, ETHICS AND PUBLIC POLICY CENTER

STATEMENT OF JOHN D. PODESTA

Mr. PODESTA. Thank you. Thank you very much. I will just summarize my statement. I want to make six quick points.

First, the committee is faced with a very serious and very delicate challenge of addressing the truly dangerous long-term deficit outlook while also ensuring our economy recovers fully from the worst recession since the Great Depression.

Both overcorrecting and undercorrecting pose serious threats to our economy. Failing to adequately address long-term deficits, on the one hand, threatens to result in a number of negative consequences, including rising interest rates and inflation that threaten the dollar. Overcorrecting, on the other hand, closing the spigot, in particular before the economy has fully recovered, would both jeopardize the economy as it currently stands and kill the prospects of job growth while making it harder, I think—and I want to underscore this point—making it harder over the long term to address the deficit outlook over the next decade.

Second, I think it is worth noting how we got here. Of course, I see this, to some extent, from the perspective of my service as President Clinton's chief of staff, but we need to know how we got here so we can make sensible choices about how to go forward.

In 1998, we had balanced the budget after inheriting a deficit of 4.6 percent of GDP. After the 2000 elections, we left the incoming Bush administration a balance sheet of a $236 billion surplus, the largest surplus since 1948. And the Congressional Budget Office projected surpluses would reach $710 billion by 2009.

By the time President Obama was sworn in, the deficit had already reached $1.2 trillion, a remarkable swing of 10 percentage points of gross domestic product.

Okay, now my microphone is on. I think you probably all heard me.

And the question is, how did we create that 10 percentage points of GDP swing? Deep tax cuts, especially for high earners, combined with the wars in Iraq and Afghanistan and the major new spending programs, were undertaken without being paid for. The predictable result of cutting taxes while increasing spending at this rate was steep fiscal decline on a scale not seen since World War II, along with an unprecedented explosion of debt. Policies enacted during that period are responsible for more than half the deficits in 2009 and 2010.

The recession, obviously, already also contributed to the erosion of near-term fiscal outlook. Tax revenues plummeted. In fact, the decline in tax revenues from 2008 was four times larger than new spending initiated since the inauguration of President Obama. Only 18 percent of the 2009 deficit is attributable to policies passed by this Congress.

The third point I would like to make is that, notwithstanding how we got here, going forward, long-term deficits do pose substantial risk to the overall economic well-being of the United States and to prospects for shared prosperity. These long-term deficits are driven largely by two underlying trends: the aging of the population, the rising of health care, combined with the chronic need for more overall revenue. These underlying trends threaten to overwhelm the Federal budget in the near future.

Meeting this challenge will require a balanced approach that includes a variety of contributing positions. Primary amongst them must be policies to bring down the cost of health care. I know that prospects for reform may seem uncertain as we sit here this morning, but the economic health of our country, as well as the health and well-being of American citizens, depends on finding a way forward in a way that produces significant delivery reform, reduces the rate of health-care inflation, and makes health-care coverage affordable for families and businesses.

In addition to controlling health-care costs, there will be a need for a renewed commitment to setting priorities, only spending taxpayer dollars on programs that work and building a smarter and more productive government that makes the most of every taxpayer dollar. We also need a sustainable and affordable national security policy and well-designed reforms to large entitlement programs, as Mr. Ryan suggested, including Social Security.

My fourth point is that it must be acknowledged by everyone who is serious about improving the Nation's fiscal future that spending cuts alone will not solve the problem. The country will need more revenue. Any serious review of the budget numbers necessarily results in that conclusion. Balancing the budget by 2019 without raising any revenue and holding Medicare and Social Security debt service and defense harmless would require cuts of 70 percent in nondefense discretionary spending. I think that would be bad for the country, and it is politically unfeasible.

Fifth, Congress can take action now to lay out a path back to fiscal sustainability. The Center for American Progress proposes an ultimate goal that is simple and straightforward: a completely balanced budget by 2020. Given the deep hole we are in, we can't get to balance immediately without doing great damage to our economy. So we proposed an intermediate goal of primary balance, which is when total revenues equal total spending, with the exception of debt service. A budget in primary balance would mean a fundamental return to responsible budgeting.

We have issued a couple of reports, and we would like to include those in the record, if that is possible.

[The report, "A Path to Balance," may be accessed at the following Internet address:]

http://www.americanprogress.org/issues/2009/12/pdf/path_to_balance.html

[The report, "Deal With It," may be accessed at the following Internet address:]

http://www.americanprogress.org/issues/2009/09/pdf/deal_with_it.html

Mr. PODESTA. But to reach these two goals, intermediate and ultimate, we are proposing specific annual targets that make steady progress in each year expressed as revenues as a share of spending, supported by a system of statutory mechanisms designed to enforce fiscal discipline that will make it difficult to deviate from that path.

Missing the annual revenue-to-spending ratio target should trigger automatic reductions in spending that would affect both traditional programs and long-view tax expenditures. To achieve deficit reduction targets will require a statutory budget enforcement regime. Statutory PAYGO, enforced by sequestration process, was effective in the 1990s to create a balanced budget and create a surplus. It can serve us well again. I praise this committee and the House for reinstating statutory PAYGO. I hope that the Senate will follow suit.

In order to really serve as a discipline on the process, PAYGO enforcement should be broadened to include not just spending but tax expenditures, in particular. Tax expenditures have the same impact on deficits as mandatory spending has had, and they have had a growing role and should not be held harmless if we are serious about enforcing PAYGO discipline. The point is not to actually have sequestration, but to force the discipline on the Congress and the White House.

And, finally, my final point is that a deficit commission appears likely, and this could prove to be a useful step forward to addressing our deficit challenges. However, a commission without a clear mandate and specific goals is likely to fail. If the purpose of creating a commission is to have a mechanism to move forward on this extremely difficult issue, it is important to charge that commission with a clearly defined goal. As noted earlier, we believe an achievable set of goals for the commission could be primary balance by 2014 and a full balance by 2020.

With that, let me thank you, Mr. Chairman. I will turn the mike over.

[The prepared statement of John Podesta follows:]

PREPARED STATEMENT OF JOHN D. PODESTA, PRESIDENT AND CEO, CENTER FOR AMERICAN PROGRESS

Mr. Chairman, members of the Committee, thank you for inviting me here today and giving me the opportunity to talk about the Center for American Progress's recent proposal for achieving fiscal sustainability.

The position you are in today is not one I envy. This committee is faced with a very serious, and very delicate challenge—addressing a truly dangerous long term deficit outlook, while also ensuring our economy recovers fully from the worst recession since the Great Depression. To get it right, policymakers must perform the metaphorical equivalent of navigating the ship of state through an extremely narrow waterway.

Both overcorrecting and undercorrecting pose serious threats to our economy.

Failing to adequately address long term deficits, on the one hand, threatens to result in a number of negative consequences. High levels of government borrowing can reduce domestic investment, raise interest rates, and spur inflation; seriously hinder the ability to make important public investments; and potentially leave us unable to stimulate the economy in a time of future crisis. The threat of sustained deficits can also lead to strong reactions by economic actors—investors, consumers, trading partners—that increase the likelihood of additional financial turbulence and threaten the stability of the dollar.

Overcorrecting, on the other hand—closing the spigot on the American Recovery and Reinvestment Act, in particular, before the economy has fully recovered—would both jeopardize our economy and kill the prospect of job growth, while also making it harder, over the long run, to address the deficit outlook over the next decade. Pursuing drastic and immediate deficit reduction when the economy has only recently returned to growth and unemployment is still at 10 percent would be an enormous mistake; fiscal retrenchment right now could lead to a double-dip recession. Those who would use current deficits as an excuse to curtail or prevent policies designed to speed the recovery are doing the country and future budgets a disservice. Recovery spending today is both necessary and entirely appropriate, even in light of the long term budget challenge. It accelerates the recovery. Taking these appropriate steps today, in order to bring the economy back to its full health, will put us in the strongest position from which to undertake deficit reduction over the longer term. Deficit spending in the near term will help produce a return to robust economic and employment growth, yielding significant dividends in terms of future deficit reduction.

Again, the challenge at hand is to strike a delicate balance—to implement measures that will restore growth, create jobs, and bring the U.S. economy back to full strength while, at the same time, laying out a credible path for stabilizing, then reducing, U.S. debt levels. The Center for American Progress has proposed a roadmap for making steady progress towards fiscal sustainability between now and the end of this decade. But before looking forward, I'd like to provide some broader context on how we arrived in this position in the years since I served in the Clinton Administration.

In 1998, we had balanced the budget after inheriting a deficit of 4.6 percent of GDP. After the 2000 elections, we left the incoming administration a balance sheet that was $236 billion in the black—the largest surplus since 1948—and CBO projected surpluses would reach almost $710 billion by 2009 based on policies then in place.

By the time President Obama was sworn in, the deficit had already reached $1.2 trillion, a remarkable swing of 10 percentage points of GDP since our Administration left office, and the debt had nearly doubled. How did we get from record surpluses to record deficits?

The near-term deficits are primarily the result of fiscal deterioration occurring since 2001. Deep tax cuts, especially for high-earners, dramatically affected the federal balance sheet, while the wars in Iraq and Afghanistan and major new spending programs were undertaken without being paid for. The predictable result of cutting taxes while increasing spending at this rate was steep fiscal decline on a scale unseen since World War II, along with an unprecedented explosion in debt. Under the previous administration, publicly held debt ballooned from $3.4 trillion to $6.3 trillion, which marks the largest increase in debt of any president in history.

Multiple independent analyses conducted by the New York Times, the Economic Policy Institute, the Center on Budget and Policy Priorities and the Center for American Progress have all shown that huge portions of current and future deficits are directly attributable to the lasting effects of those policies. Policies enacted during this period are responsible for more than half of the deficits in 2009 and 2010; the cost of the Bush tax cuts alone, if not permitted to expire, will exceed $5 trillion over the next ten years.

The recession has also contributed to the corrosion of the near-term fiscal outlook. Tax revenues plummeted; in fiscal year 2009, they dropped to their lowest point since 1950. In fact, the decline in tax revenues from 2008 was four times larger than all new spending initiated since the inauguration of President Obama. Only 18 percent of the 2009 deficit is attributable to policies passed by this Congress.

The country is in a weaker economic and fiscal position today not because of the American Recovery and Reinvestment Act that passed in 2009, but because of fiscal policy and regulatory decisions made in previous years. Having said that, it is also clear that going forward, long-term deficits pose substantial risks to the overall economic well-being of the United States and to prospects for shared prosperity. These long-term deficits are driven largely by two underlying trends: the aging of the population and the rising cost of health care. During the past eight years, these two trends went unaddressed, even as the dangers they posed to our long-term fiscal health became clearer and clearer. Combined with a chronic need for more overall revenue, these underlying trends threaten to overwhelm the federal budget in the near future. According to current projections, the federal budget deficit will remain well above four percent of GDP for at least the next ten years and will balloon even further afterwards. If we allow that to take place, publicly held debt will mushroom from around 50 percent of GDP currently to over 80 percent by 2019. The scale of these challenges means that there are no easy or simple answers. Meeting the challenge will require a balanced approach that includes a variety of contributing solutions. Primary among them must be policies that bring down the costs of health care. Let me underscore this point: there can be no return to fiscal sustainability without substantial health reform. While the prospects of reform may seem uncertain as we sit here today, the economic health of our country—as well as the health and wellbeing of American citizens—depends on finding a way forward on health reform that produces significant delivery reform, reduces the rate of health care inflation, and makes health coverage affordable for families and businesses.

In addition to controlling health care costs, there needs to be a renewed commitment to setting priorities, only spending taxpayer dollars on programs that work, and building a smarter, more productive government that makes the most of every tax dollar. We will also need a sustainable and affordable national security policy and welldesigned reforms to large entitlement programs, including Social Security.

Finally, it must be acknowledged by everyone who is serious about improving the nation's fiscal future that spending cuts alone will not solve the problem. The country will need more revenue. Any serious review of the budget numbers necessarily results in this conclusion. For example, balancing the budget by 2019 without significant cuts to certain priorities such as debt-service payments, defense spending, Medicare or Social Security and without raising any additional revenue would lead to cuts in the rest of the budget of close to 70 percent. Cuts of that magnitude are both unrealistic and unwise. Simply put, those who suggest deficit reduction can be achieved only through spending cuts or only through tax increases misunderstand the enormity of the challenge.

It is also worth noting that the last time we faced a major budget problem in the 1990s, tax increases were a significant part of the solution, and the country enjoyed the longest period of continued economic growth in history. The supply-side economic policies pursued during the subsequent decade proved far less effective, whether measured by growth in the overall economy, job creation, or median wage growth. We believe that Congress can take action now to lay out a path back to fiscal sustainability. Many of the dangers of large, persistent deficits stem from the perception that the budget is permanently out of balance. A reasonable, realistic plan to get the budget back in the black would alleviate those fears. And while, as I've already mentioned, it would be extremely unwise to try for immediate fiscal retrenchment, setting out a path allows us to take meaningful, concrete steps toward the ultimate goal without risking economic backsliding.

We propose an ultimate goal that is simple and straightforward: a completely balanced budget by 2020. During good economic times, there is no reason to run deficits. The default position of the federal budget should be balance, and the red ink should be reserved for recessions and emergencies. However, given the deep hole in which we currently find ourselves and the strength of underlying trends, we cannot rush to full balance right away. The magnitude of the problem is simply too large to try and solve it all in one fell swoop.

That is why we have proposed an intermediate goal, in addition to the ultimate goal, that can be set in the near-term and which will, if reached, put the budget on much stronger ground. We believe that intermediate goal should be primary balance. Primary balance is when total revenues equal total spending with the exception of debt service payments. A budget in primary balance would mean a fundamental return to responsible budgeting—we would not be borrowing to pay for any government programs, services or public benefits. Furthermore, budgets in primary balance have historically resulted in a declining debt-to-GDP ratio.

To reach these two goals, intermediate and ultimate, we are proposing specific annual targets that make steady progress in each year. These targets are expressed as revenues as a share of spending. In fiscal year 2009, for example, federal revenues covered only 60 percent of all spending. Our proposal has that ratio going up to 100 percent over the next ten years, with targets in each individual year. These annual targets will need to be supported by a system of statutory mechanisms designed to enforce fiscal discipline that will make it difficult to deviate from the path. To accomplish this, we would recommend that missing the annual revenue to spending ratio target trigger automatic reductions in spending that would affect both traditional programs and tax expenditures. The point is not to trigger sequestration, but to ensure that the consequences of failure are clear and therefore avoided. Of course, the statutory regime should also include "safety-valve" measures to allow for flexibility if weak economic conditions persist or reappear.

To achieve deficit reduction targets will require a statutory budget enforcement regime. It was, in part, through statutory provisions that included PAYGO that the budget discipline of the 1990s was achieved and the surpluses of that era accomplished. Statutory PAYGO enforced by a sequestration process has been effective in the past and can again serve us well as we address our fiscal challenges.

The House is to be praised for reinstating statutory PAYGO and the Senate should follow suit. We believe, however, that in order to really serve as a discipline on the process PAYGO enforcement should be broadened to include not just spending but taxes as well-tax expenditures in particular. Tax expenditures have the same impact on deficits as mandatory spending, have had a growing role and should not be held harmless if we are serious about enforcing PAYGO discipline.

A deficit commission appears likely and this could prove to be a useful step forward for addressing our deficit challenges. However, a commission without a clear mandate and specific goals is likely to fail. If the purpose of creating a commission is to have a mechanism to make progress on an extremely difficult issue, then it is important to charge that commission with a clearly defined goal. Otherwise, the commission is likely to do no better than any other process in getting us closer to a fiscally responsible budget. As noted earlier, we believe an achievable set of goals for the commission could be primary balance by 2014 and full balance by 2020.

There is no doubt that we face serious fiscal challenges in the years ahead. Persistent deficits carry with them significant risks and simply cannot be tolerated in perpetuity. Acting hastily would also be dangerous and therefore substantial deficit reduction should be delayed until the economic recovery is stronger. But we can take steps now to mitigate many of the most serious risks that stem from our long-term budget woes. By adopting an appropriate path to fiscal sustainability, complete with annual targets, we will demonstrate a real commitment to getting the budget gap under control. In the near term, achieving primary balance will prevent our debt level from rising further and it will put the government in a much stronger position to realize the long-term goal of complete balance. Though the challenge is certainly daunting, it is not insurmountable. Adopting a path to balance, such as the one we have proposed, is a good first step toward meeting that challenge.

Chairman SPRATT. Thank you, Mr. Podesta.

Maya MacGuineas?

STATEMENT OF MAYA MACGUINEAS

Ms. MACGUINEAS. Thank you. Good morning, Chairman Spratt, Congressman Ryan, members of the committee. Thank you so much for the opportunity to appear here today.

I am here to discuss the work of the Peterson-Pew Commission on Budget Reform, which in December released a proposal which included a six-step plan to address the growing Federal debt, which I will summarize in just a moment.

The main points I would like to emphasize today are that what was once a long-term fiscal problem has become a more immediate one, which requires that we take action much sooner than we needed to a few years ago. We no longer have the luxury of time on our side.

Number two, it is important to focus on stabilizing the debt so that it declines to a reasonable level and that it is no longer growing as a share of the economy. For many years, we have focused on deficits. The debt has now reached a level where it is about to hamper our fiscal flexibility, and that is something we think is important to focus on.

Number three, policymakers must balance the need to act quickly to avert a fiscal crisis with the need not to destabilize the economic recovery. We recently have just started something, copying Greg Mankiw on the Pigou Club, called the Announcement Effect Club, which basically says there is a growing call of people to commit to a fiscal plan immediately in order to buy us time to reassure credit markets that we are serious about fiscal reforms. And that allows us to gradually phase in those changes to not, sort of, stave off the recovery as it is getting started.

Number four, the best approach would be to immediately commit to and develop a credible plan to stabilize the debt and then to start phasing it in gradually once the economy is strong enough. We suggest starting in 2012, judging from projections about economic recovery right now.

Number five, the policies that will stabilize the debt in the medium term and close the longer-term fiscal gap are somewhat different. Both will be needed.

Number six, a credible plan will have to be aggressive enough to reassure credit markets.

And, number seven, the economic risks of doing nothing are tremendous, likely leading either to a fiscal crisis or an ongoing deterioration of the U.S. standard of living.

That the country faces these tremendous challenges is not news to anyone on this committee. And, under reasonable assumptions, the debt will grow as a share of the economy indefinitely. At some point, this will push up interest rates and interest costs as a share of the budget, requiring more borrowing and creating a vicious debt spiral.

We receive increasingly regular warnings from credit-rating agencies, to what we hear from the Chinese officials worried about their investments in the U.S., to what we see happening in overleveraged nations around the world.

The Peterson-Pew Commission suggests that Congress and the White House follow a six-step plan to right the fiscal course. The first step, then, would be to commit immediately to stabilizing the debt at 60 percent of GDP by the year 2018. Step two would be to develop a specific and credible stabilization package in this year, 2010. Step three would be to begin phasing it in in 2012. Step four would be to review progress annually and implement an enforcement regime to stay on track, quite like what we just heard with triggers and specific annual goals. Step five would be to stabilize that debt by 2018, but, given historical debt levels, we don't think that goes far enough. And over time, step number six is to continue to reduce the debt as a share of the economy over the longer term.

So there are a few points I do want to emphasize.

One, prior to the economic crisis, we at the Committee for a Responsible Federal Budget were worried about the long-term fiscal problems facing the country, driven primarily by the aging and health-care cost problems. But now, due to the deficits we ran before the recession, the effects of the recession, the policies put in place to deal with the recession, and a host of additional expensive policies that Congress and the White House support, the debt has grown dramatically, and it is on course to reach unacceptably high levels much sooner than what used to be a multi-decade problem.

Policymakers will have to act quickly to reassure credit markets. There is no single right goal. But given that the average debt levels over the past were 40 percent of GDP, it is quite likely that aiming to stabilize the debt at, say, twice that amount would not be sufficient to reassure markets.

So I am certainly not going to criticize any other approaches. I don't think there is any single right goal. And I think it is really important that people who share these objectives spend their energy, kind of, reinforcing the need to do something, rather than disagreeing about the details of what specifically needs to happen. And I think it is wonderful that, in the past couple months, a growing number of groups have put specific ideas on the table.

I will point out two things.

One, part of the reason we were able to respond to this economic crisis was that we had the fiscal flexibility to do so. Our debt levels were low when we entered this downturn, and that allowed us to borrow. We can disagree about whether the stimulus was necessary or whether it was right, but it allowed us to respond in many ways to what could have, I believe, potentially been a devastating economic crisis. If we had been running debt that was at 60, 70 percent of GDP, we never would have had that fiscal flexibility.

Second, the kind of goals, the numbers that we are suggesting to stabilize the debt at 60 percent of GDP are certainly aggressive, but they are really only aggressive when you compare them to current policies. If you look at them compared to current law under the targets that we are looking at, you would not actually have to have deficits that are lower than current law until the year 2015. It certainly is going to be a heavy political lift no matter what, but we got ourselves into a very large problem, and it is going to take some pretty aggressive measures to reassure credit markets that we are serious about getting out of them.

The time frame for a plan should not be too long, helping to mitigate the political risk that, at the first sign of improvements, policymakers jump ship and go back to the easier policies of cutting taxes and increasing spending. So our proposal lasting from 2012 to 2018 we think is a reasonable time frame.

It is also likely that the policies that will be most palatable to bring the debt to a reasonable level over a reasonable time period are going to be different in the medium term than in the longer term. In the shorter term, we have to look for changes that can be implemented quickly. History shows that policymakers are more likely to cut discretionary spending and increase taxes to get immediate deficit reduction.

If that turns out to be the case, we have to recognize that these changes will not keep the debt from going over the long term. In order to stabilize the debt, we will have to make changes to the drivers of the debt's growth, those programs that are expanding due to the aging of health-care costs, particularly Social Security and Medicare, and any package should include policies that meet both time horizons. Basically, everything has to be on the table.

Congressman Ryan had to step out, so I am not going to respond to his challenge right now, but I appreciated it, that we need to get specific about entitlement reforms. And if there is a chance during discussion, I will put forward all sorts of specifics that people here may not want to talk about yet, but we are going to have to switch the discussion from, kind of, fiscal goals which are critically important now and get specific pretty quickly. So I am happy to jump in, if that is useful.

Thank you so much for the opportunity.

[The prepared statement of Maya MacGuineas follows:]

PREPARED STATEMENT OF MAYA MACGUINEAS, PRESIDENT, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Chairman Spratt, Congressman Ryan, and Members of the Committee, good morning and thank you for inviting me here today to share my views on bipartisan process proposals for long-term fiscal stability. It is a privilege to appear before this Committee.

I am the President of the bipartisan Committee for a Responsible Federal Budget. Our Co-Chairs are Congressmen Bill Frenzel, Tim Penny and Charlie Stenholm, and the Board is made up of past Directors of the Office of Management and Budget, the Congressional Budget Office, and the Government Accountability Office, as well as Chairmen of the Federal Reserve Board and the Budget Committees, and other budget experts. I am also the Director of the Fiscal Policy Program at the New America Foundation, a non-partisan think tank here in Washington D.C. Today, I am here to discuss the work of the Peterson-Pew Commission on Budget Reform, which, in December, released Red Ink Rising: A Call to Action to Stem the Mounting Federal Debt, which proposes a six-step plan to address the growing federal debt.

The main points I would like to emphasize today are:

- What was once a long-term fiscal problem has become a medium-term problem that requires that we take action much sooner than was needed a few years ago.
- It is important to focus on stabilizing the debt, so that it declines to a reasonable level and is no longer growing as a share of the economy.
- Policymakers must balance the need to act quickly to avert a fiscal crisis caused by our growing debt with the need not to destabilize the economic recovery.
- The best approach would be to immediately commit to and develop a credible plan to stabilize the debt, and to start phasing it in gradually once the economy is strong enough—we suggest starting in 2012.
- The policies that will stabilize the debt in the medium-term and close the longer-term fiscal gap are somewhat different—both are needed.
- A credible plan will have to be aggressive enough to reassure credit markets.
- The economic risks of doing nothing are tremendous—likely leading either to a fiscal crisis or an ongoing deterioration in the U.S. standard of living.

That the country faces tremendous long-term budget challenges is not news to anyone on this Committee. It is not the massive trillion-dollar-plus deficit of the past year that is so troubling, but that there is no plan to put the budget on a sustainable path in future years. Under reasonable assumptions, the debt will be growing as a share of the economy indefinitely; at some point this will push up interest rates and interest costs as a share of the budget, requiring more borrowing and creating a vicious debt spiral. If not addressed, this will ultimately lead to a fiscal crisis.

Just last week, Fitch Ratings warned that if the U.S. does not take action, government debt by the second half of this decade could threaten the nation's AAA bond rating. And the increasingly regular warnings—from what we hear from Chinese officials worried about their investments in U.S. bonds, to what we see with over-leveraged nations around the world—provide a steady reminder of the urgency of this problem.

It is within that context that the Peterson-Pew Commission on Budget Reform is calling for Congress and the White House to take immediate action to stem the growing federal debt. Our proposal is crafted both to accommodate the needs of the still-recovering economy, and reflect the tremendous risks posed by the large and expanding debt burden. We recognize that fiscal problems of this size cannot be fixed overnight or even in a year. Indeed, rushing the process could harm the economy, choking off the budding recovery. But to buy some breathing room, the United States must show its creditors that it is serious about stabilizing the federal debt over a reasonable timeframe. Both spending cuts and tax increases will be necessary.

We recommend that Congress and the White House follow a six-step plan:

Step 1: Commit immediately to stabilize the debt at 60 percent of GDP by 2018;

Step 2: Develop a specific and credible debt stabilization package in 2010;

Step 3: Begin to phase in policy changes in 2012;

Step 4: Review progress annually and implement an enforcement regime to stay on track;

Step 5: Stabilize the debt by 2018; and

Step 6: Continue to reduce the debt as a share of the economy over the longer term.

1. Commit immediately to stabilize the debt at 60 percent of GDP by 2018.

Congress and the White House should immediately commit to stabilizing the public debt at a reasonable level over a reasonable timeframe: we recommend 60 percent of GDP by 2018. Waiting too long could fail to reassure creditors—one of the primary objectives of acting quickly. The "announcement effect" of such a commitment, if credible, can have positive economic effects by signaling that the United States is serious about reducing its debt. We believe that the 60 percent goal is the most ambitious yet realistic goal that can be achieved in this timeframe. The 60 percent debt threshold is now an international standard—regularly identified by the European Union (EU) and the International Monetary Fund (IMF) as a reasonable debt target. A more ambitious target could easily prove to be such a heavy political lift that lawmakers would not embrace it or it would not be credible. Given the significant risks of high U.S. debt, however, a less aggressive target might be insufficient to reassure markets. While cutting government spending or raising taxes too early could slow or reverse the economic recovery, other countries have shown that a credible commitment to reducing the debt prior to actual policy changes can improve creditors' expectations and diminish the risks of a debt driven crisis.

2. Develop a specific and credible debt stabilization package in 2010.

A glide path for getting from today to 2018 is critical. So are the specific policies. Congress and the White House must agree on the necessary reforms and the timing for implementing them. We do not recommend a specific mix but believe that both spending cuts and tax increases will be necessary. Under the Commission's fiscal baseline, average annual deficits are projected to be about 6 percent of GDP. To meet the proposed goal, the average deficit would need to shrink to about 2 percent. For illustrative purposes, we propose a glide path that starts gradually with a deficit of 5 percent in 2012 and that requires a deficit of less than 1 percent by 2018. We allow seven years for the plan so that the impact of policy changes made in any single year is not drastic and does not stall the recovery of the economy.

The magnitude of deficit reduction needed to reach the 60 percent goal depends on the level of debt when policymakers start. If no new deficit-financed policies were added to the budget and any extensions of expiring policies were paid for, deficits would average around 3 percent of GDP, instead of 6 percent, and would only need to shrink to around 2 percent to meet the Commission's goal—clearly a more manageable scenario.

3. Begin to phase in policy changes in 2012. Given current economic conditions, we recommend waiting to implement the policy changes until 2012. Clearly, policymakers need to closely monitor economic conditions between now and then, but making aggressive changes any earlier could harm the economic recovery, particularly with unemployment reaching a 25-year high in 2009. However, waiting any longer could undermine the plan's credibility and leave the country reliant on excessively high borrowing for too long with no plan in place to change course. Some policymakers will no doubt try to use the struggling economy as an excuse for delay. Keep in mind however, that not putting a plan in place could derail the economic recovery.

4. Review progress annually and implement an enforcement regime to stay on track. Once a plan is adopted, it will be critical to have a mechanism to ensure that it stays on track. We suggest a broad-based companion enforcement mechanism, or a "debt trigger." The trigger would take effect if an annual debt target were missed. Any breach of the target would be offset through automatic spending reductions and tax increases. The Commission recommends that the trigger apply equally to spending and revenue. There would be a broad-based surtax, and all programs, projects, and activities would be subject to this trigger. The trigger should be punitive enough to cause lawmakers to act but realistic enough that it can be pulled as a last resort if policymakers fail to act or select policies that fall short of the goal.

5. Stabilize the debt by 2018.

Reducing the debt to 60 percent of GDP will be no small feat. It will require small changes in the first year from the projected level of 69 percent to 68 percent but, more significantly, will require a dramatic deviation from the current debt path. Preventing that projected path is critical for the United States if it is to avoid the economic risks associated with excessive debt.

But hitting a 60 percent target is, in and of itself, not a sufficient goal. What matters just as much—if not more—is that the debt does not continue to grow as a share of the economy thereafter. This makes deriving a package of revenue increases and spending cuts to bring the debt down to 60 percent even more difficult. It would be easier if policymakers could implement temporary measures, timing shifts, and short-term policies that did not address the major drivers of the budget's growth. This shortsightedness, however, would leave the debt on track to grow again after the medium-term goal was achieved. To be effective over the longer term, a stabilization package will have to include permanent changes to current policies and must be weighted to control the budget's most problematic areas.

We believe the problem is so large that nearly all areas of the budget will be affected, and certainly both spending and taxes will have to be part of the ultimate package. Reforms in programs that are growing faster than the economy—notably Medicare, Medicaid, Social Security, and certain tax policies—afford the best opportunities for savings and will provide the greatest benefits to longer term debt stability.

6. Continue to reduce the debt as a share of the economy over the longer term.

Though preventing the debt from expanding again over the coming decades will be quite challenging given the demographic and health care cost pressures, we believe that policymakers must, over time, bring the debt down beyond the initial 60 percent target to something closer to the U.S. historical fifty-year average of below 40 percent. Fiscally-responsible federal policies are necessary so that the government has the fiscal flexibility to respond to crises. Even though the United States had budget deficits when the recent economic and financial crises hit, the relatively low level of debt as a share of the economy gave policymakers the ability to respond quickly and borrow large amounts to respond to those crises without worrying about the federal government's ability to borrow. If the debt level had been at its current level, or where it is projected to grow to, responding to the economic crisis would have been much more challenging.

We know that the policies to achieve any of these fiscal improvements are difficult, involving spending reductions or tax increases, and in all likelihood both. In the absence of a single fiscal goal, though, it is too easy for lawmakers to oppose any set of hard choices others suggest without offering alternatives.

Implementing reforms that slow the growth of government spending, keep revenue apace with spending, and are conducive to economic growth will be critical to bringing down the debt levels further. Ultimately, this task will almost certainly require more than one package of debt reduction. The Commission hopes that Congress and policymakers will monitor the debt to ensure that it stays at a manageable level and does not grow faster than the economy. Ensuring the future fiscal health of the country depends on it.

This year we will publish a detailed companion report with additional recommendations on reforming the budget process. That report will also propose budget process tools to help lawmakers reach and maintain a stable level of debt. We very much hope to work closely with the members of this Committee in developing this plan.

And I would like to take the opportunity to elaborate on a few points I think are particularly important.

Prior to the economic crisis, we, at the Committee for Responsible Federal Budget, were worried about the long-term fiscal problem facing the country, driven primarily by aging and growing health care costs. But as a result of 1) running deficits prior to the recession, 2) the lower revenues and higher spending due to the recession, 3) the policy costs of dealing with the recession, and 4) a host of new costs that both the administration and Congress support, the debt has grown dramatically and is on course to reach unacceptably high levels. What used to be a multi-decade problem is now at our doorstep.

Policymakers will have to act quickly to reassure credit markets that the United States will soon shift course to a more sustainable fiscal path. This will require committing to such a change immediately; beginning to phase in changes as soon as the economy will tolerate them; and pursuing a fiscal goal that is sufficiently aggressive to reassure credit markets. There is no single "right" goal, but given that average debt levels over the past 50 years were below 40 percent of GDP, it is quite likely that aiming to stabilize the debt at twice the historical level, for instance, will not be sufficiently credible.

Another risk of a fiscal plan that has a long timeframe is the political risk that once policymakers see signs of progress, rather than sticking to the plan, they will switch course and return to the politically more popular exercise of increasing spending and cutting taxes. Therefore, we believe the timeframe for a plan should not be too long. Annual debt goals combined with an automatic trigger mechanism will also help keep policymakers on track.

The bottom line here is that time is a luxury we no longer have.

It is also likely the policies that will be most palatable to bring the debt to a reasonable level over a reasonable time period are in many cases different than those that will keep the debt from growing again in the longer term. In the medium-term, we have to look for changes that can be implemented reasonably quickly. History shows that policymakers are more likely to cut discretionary spending and increase taxes to get immediate deficit reduction.

These changes, however, will not keep the debt from growing over the longer-term. In order to stabilize the debt over the long-term, we will have to make changes to the drivers of the debt's growth, those programs that are expanding due to aging and health care costs—including the largest mandatory spending programs, Social Security and Medicare.

A reasonable package will have to include both the policies necessary to reduce the debt as a share of the economy over the medium term and keep it under control over the longer-term. The likely time horizon of policy changes only makes it more important to recognize that all areas of the budget will have to be on the table in order to craft a credible and effective debt stabilization package.

I will stop here. We realize the immense difficulty of the task ahead of policymakers. Our board members have either been in Congress or worked closely with Members throughout their careers and know the political and policy challenges we now face—although frankly many of them are concerned that the challenge we face at this moment is the worst they have seen in their careers. For that reason, as difficult as it will be to develop a plan to put the debt on a sustainable course, there is no other option and that action to set the changes in motion must begin right away.

Once again, thank you for the opportunity to appear here today and I look forward to your questions.

Chairman SPRATT. Thank you for coming.

Robert Greenstein?

STATEMENT OF ROBERT GREENSTEIN

Mr. GREENSTEIN. I thank you, Mr. Chairman.

Last week, the Center on Budget and Policy Priorities released our latest long-term budget projections. Our work isn't unique here. Over the last 8 months, new long-term budget projections and analyses have been issued by CBO; GAO; the Peterson-Pew Commission, as you just heard; a committee established under the auspices of the National Academy of Sciences and the National Academy of Public Administration; and a team of economists at the University of California and Brookings.

What is striking is the degree of consensus across all of these analyses, not just on the numbers, in a sense, but on their significance and what they mean. Basically, all of these enterprises support the same conclusions on five key points.

Number one, the deficits and debt will skyrocket in coming decades if current policies remain unchanged, and the debt at the levels projected ultimately would significantly damage the economy.

Number two, that the continued rapid growth in per-person health-care costs is the single biggest reason for the projected increases in deficits and debt over the long term. It affects not only outlays for Federal programs but it also reduces tax revenue by making less and less of compensation in the form of taxable income.

Number three, that the absolutely essential goal that must be met is to avoid a debt explosion, to prevent the debt from perpetually rising as a share of the economy. That is, as Maya just said, to stabilize the debt as a share of the economy. That is the bottom-line goal that has to be met.

Number four, that it is not necessary to balance the budget to achieve the goal. As the National Academy of Sciences report notes, the debt can be stabilized at reasonable levels if deficits are held to somewhere in the range of 2 to 3 percent of the gross domestic product.

And, lastly, it will almost certainly require a combination of changes in both revenues and spending to achieve this.

Now, as John Podesta noted, we are not talking here about the deficits this year or next year. Deficits are absolutely necessary now to deal with the weak economy. In fact, I think more needs to be done to shore up the economy. We are talking, obviously, about deficits over the longer term.

And dealing with the long-term budget problem, I would argue, should not be the concern just of deficit hawks or people thought of as green-eyeshades types. If the budget is not put on a sustainable path, it is my view that, over the long term, low- and moderate-income families will be among those who suffer the most from the inevitable erosion of the standard of living.

Let me turn now to the question of what might be an appropriate fiscal target for the years ahead, the years that will be covered by the next budget resolution that this committee will write in the coming months.

And before getting into the specifics, let me raise two concerns. One concern is the potential of not having a meaningful fiscal target at all. The other concern is setting a fiscal target that goes beyond what we need to stabilize the debt and is so severe that it is politically unattainable and, as a result of that, just gets blown away and is the same as having no target at all. That is what happened with the Gramm-Rudman-Hollings law in the late 1980s.

Now, three of the reports that I mentioned set a specific goal: ours, Pew-Peterson, and the National Academy of Sciences, in conjunction with their long-term fiscal forecasts. And in all of them, the goal is to stabilize the debt as a share of the gross domestic product over the coming years.

In determining more specifically what that goal might be, we need to take two things into account. The first is we should not and cannot start cutting deficits in the next few years while the economy is still on its back. And the second is that—and you could take Social Security as an example; it will help focus one's mind on this. Many of the changes that are ultimately going to have to be made are going to have to be phased in over a number of years. Think about changes one might make in Social Security, and it becomes clear one would phase them in over a number of years.

We recommend, based on this, stabilizing the debt in the years ahead by setting a target of reducing the deficit to no more than 3 percent of the gross domestic product in the years after the economy recovers. If one did that, that would result in—it would succeed in stabilizing the debt. The debt would be initially stabilized at slightly over 70 percent of the gross domestic product.

Now, the Peterson-Pew Commission and the NAS panel set a target of 60 percent of GDP. And, in my view, that would be a very large mistake. Not only is it overly ambitious, more than is needed to stabilize the debt, but my concern is that it would be self-defeating because it would require targets so extraordinarily daunting that you wouldn't meet them.

We ran the numbers yesterday and found that to get to 60 percent of GDP by 2018 would require deficit reduction averaging $800 billion a year in tax increases and spending cuts each year from 2013 through 2018, and over the 10 years from 2013 through 2022, between $8 trillion and $9 trillion in tax increases and spending cuts. This doesn't count additional savings in interest costs on the debt.

Maya noted that, under this path, you wouldn't have to cut deficit far below current law in the next few years, but current law isn't real, as you all know. Current law would entail a 21 percent cut immediately in physician payments, under the SGR; 40 million households within 2 years being added to the AMT; repeal of every one of the tax cuts, including the middle-class ones—or the expiration of all of the tax cuts, including the middle-class ones enacted in 2001 and 2003. No disrespect intended, but you aren't going to do that.

So, my concern, again, is to set a target that gets to the goal, which is stabilizing the debt and avoiding a debt explosion, that is one you can enforce and you can meet.

I would note that there is absolutely no evidence that a debt-to-GDP ratio of 60 percent, or any other particular percentage, is the particular target needed to avoid harm to the economy. The National Academies report is quite explicit that there is no magic number, there is no particular number. There is one piece of economic research on this that does find evidence that economic growth falters when government exceeds 90 percent of GDP, and I don't propose we go that high. My point is simply we have to stabilize the debt. We have to have a path to get there, and it needs to be a path that can really be met.

Now, what I am proposing, which is a target of deficits down to 3 percent of GDP, is really tough itself. The target that I am proposing would require spending cuts and tax increases of $400 billion a year, starting within a few years after the economy recovers. That alone would be really, really tough.

So I think the history involving the Gramm-Rudman-Hollings law and the like suggests that if we set overly ambitious goals, we actually can have the unintended effect of making continued inaction more likely. If we recall the late 1980s, when we had a path under Gramm-Rudman of annual deficit targets getting down to zero that were not remotely realistic, what it produced was a cottage industry on both sides of the aisle of how to do rosy assumptions, how to print budget gimmicks in the budget, how to have a charade that we were meeting the targets in order to avoid sequestration. And when that didn't work, we just waived the targets or the sequestration away anyway.

What we need is a path after the economy recovers that we can adhere to. Our first step is to avoid the debt explosion. For the long term, I would agree there would be desirability in stabilizing the debt at a level lower than 70 percent. Let's first achieve the goal of stabilizing. Once we get there, we can talk about the necessary steps it would entail to go further and whether the Congress is willing to take them.

But my fear is one of continued inaction. Therefore, my recommendation is: Set the essential goal, stabilizing the debt, recognize what that means, deficits down to 3 percent of GDP, and figure out how to get there, putting everything, revenues and spending, on the table.

Thank you.

[The prepared statement of Robert Greenstein follows:]

PREPARED STATEMENT OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

Mr. Chairman, Congressman Ryan, and members of the Committee, I appreciate the opportunity to appear here today to discuss the long-term budget problem facing the United States.

Last week, the Center on Budget and Policy Priorities released a new analysis presenting our latest long-term projections of federal spending, revenues, deficits, and debt under current policies and our conclusions about the changes that need to be made in those policies.[1]

It will be no surprise to any of you who have heard us testify before on the long-term budget outlook—or have heard from any number of other experts on this subject in recent years—that we conclude the United States faces a very serious deficit problem if current policies remain unchanged. The problem ultimately will threaten the economic health of the country and compromise the ability of the government to meet crucial national needs.

Let me be clear. I am not talking about the large deficits we face this year or in the next few years. We all wish that the economic downturn and near meltdown of the financial system that have driven current deficits to such high levels had not occurred. But, given the circumstances we have been confronting, those deficits not only are acceptable but are the necessary result of those circumstances and the efforts required to shore up the financial system and put the economy back on a sound footing. If we had tried to hold down the deficit over the last year, or if we try to cut deficits before the economy is healthy enough to absorb such action—the Congressional Budget Office has projected that the U.S. gross domestic product (GDP) will not be back to its potential level until 2013 and unemployment will remain above its "natural" rate until 2014—the country will be worse off.

The problem I am talking about is what we project will happen to deficits and debt in coming decades under current policies (and assuming the economy is healthy). We project that deficits will rise to more than 20 percent of GDP by 2050 and that debt will soar to the unprecedented level of about 300 percent of GDP by mid-century. (The highest level of debt experienced in the United States was 110 percent of GDP, at the end of World War II.) As the Congressional Budget Office and others have pointed out, over the long run, such high levels of debt would constrain the standard of living of residents of the United States and increase the risk of a financial crisis that could seriously disrupt the economy and the budget.

I believe it is absolutely necessary for policymakers to address this problem, and the sooner the better (with the caveat that tax increases or spending cuts that would threaten the recovery should not be implemented until the economy is back on track). As the founder and Executive Director of an organization that is dedicated to promoting efforts to improve the lives of low- and moderate-income Americans, I want to stress that dealing with the long-term budget problem should not just be the concern of "deficit hawks" or "green-eyeshade" types. If the budget is not put on a sustainable path, it is likely that low- and moderate-income Americans will suffer the most from the inevitable erosion of the average standard of living in this country. And, if rising debt does trigger a financial crisis, programs that are crucial to the well-being of less-well-off Americans are likely to bear the brunt of draconian steps taken in that crisis atmosphere to reduce deficits and debt and reassure financial markets. No one with particular concerns about the well-being of low- and moderate-income Americans can afford to ignore the long-term budget problem.

PUTTING THE BUDGET ON A SUSTAINABLE PATH

Now let me say more about the nature of the long-term problem and what has to be done to put the budget on a sustainable path. One of the striking things about this is the degree of consensus among budget experts—striking because there is so little consensus about most other budget issues.

In the last eight months, budget projections and analyses of the scope of the fiscal problem over the long term have been issued not only by the Center on Budget and Policy Priorities, but also by CBO, the economists Alan Auerbach of the University of California at Berkeley and William Gale of the Brookings Institution, the Government Accountability Office, a commission supported by the Peter G. Peterson Foundation and the Pew Charitable Trusts, and a committee established under the aus-

[1] Kathy Ruffing, Kris Cox, and James Horney, "The Right Target: Stabilize the Federal Debt," Center on Budget and Policy Priorities, January 12, 2010.

pices of the National Academy of Sciences and the National Academy of Public Administration.[2]

These reports—produced by organizations and individuals with varied interests and outlooks—all support the same conclusions on a number of key points:

- That deficits and debt will skyrocket in coming decades if current policies remain unchanged;
- That debt at the levels projected would seriously threaten the budget, the economy, and the well-being of the people of the United States;
- That the continued rapid growth of per-person health care costs is the single biggest reason for the projected long-term increases in deficits and debt (with demographic changes—the aging of the baby-boom population—contributing to a significant but lesser extent to the projected increases);
- That the absolutely necessary goal of policymakers to avoid this outcome is to prevent the debt from perpetually rising as a share of the economy—that is, to stabilize the debt-to-GDP ratio;
- That it is not necessary to balance the budget to achieve this goal—that debt could be stabilized at levels projected for the middle of this decade if deficits are no more than about 3 percent of GDP or a bit less; and;
- That it will almost certainly require a combination of increases in revenues and reductions in spending to put the budget on a sustainable path. (The reports do not all say this explicitly, but it would be hard for a thoughtful reader to conclude that any of the reports suggest that solving the problem solely on the revenue or the spending side of the budget is feasible.)

As I noted, this degree of consensus among budget analysts on such an important issue is striking. It is true that there is a great deal of uncertainty about what will happen to the economy and the budget in coming decades. Nevertheless, this consensus among a variety of analysts should give pause to anyone who is tempted to believe that it would be prudent to ignore the problem posed by the current budget path or to assert that we can "grow our way out of it."

SETTING A FISCAL TARGET

Among the three reports that propose a specific fiscal target for lawmakers—the Center's report and the reports by the Pew-Peterson commission and NAS-NAPA committee—there is agreement that the general goal should be to stabilize the debt-to-GDP ratio within the next decade. The Center specifically calls for deficits to be reduced to no more than 3 percent of GDP by 2019, and preferably sooner. Given the need to avoid implementing cuts in the next few years that could undercut the economic recovery and to allow for a gradual phasing in of some cuts once they do begin, we assume that the debt would be stabilized at somewhat over 70 percent of GDP over the course of the decade. The Pew-Peterson commission and the NAS-NAPA commission both propose a goal of stabilizing the debt-to-GDP ratio at a lower level, 60 percent of GDP.

We believe that a goal of ensuring that debt is stabilized at 60 percent of GDP in this decade is both overly ambitious and unnecessary, and as explained below, is likely to be self-defeating. Under current policies, we project that debt will be about 70 percent of GDP at the end of 2012 and that deficits in 2013 through 2018 will average about $1 trillion a year, or 6 percent of GDP. For debt to equal 60 percent of GDP at the end of 2018, the deficits in 2013 through 2018 would have to be cut by an average of about $800 billion a year (or 4 percent of GDP a year), including interest savings. This is an extremely ambitious goal. The largest deficit reduction efforts in the last three decades trimmed deficits by about 2 percent of GDP.

More importantly, while it is necessary to stabilize the debt-to-GDP ratio, it is not necessary to adopt a target of 60 percent. There is no evidence that a debt-to-GDP ratio of 60 percent represents a threshold above which the potential harm to the economy rises to an unacceptable level, and some evidence that that threshold is somewhat higher. There is little empirical basis for any particular debt-to-GDP target, although an analysis of historical international data by economists Carmen M. Reinhart and Kenneth S. Rogoff suggests that economic growth falters when govern-

[2] Congressional Budget Office, "The Long-Term Budget Outlook," June 2009; Alan J. Auerbach and William G. Gale, "The Economic Crisis and the Fiscal Crisis: 2009 and Beyond: An Update," September 2009; Government Accountability Office, "The Federal Government's Long-Term Fiscal Outlook: Fall 2009 Update," October 2009; Peterson-Pew Commission on Budget Reform, "Red Ink Rising: A Call to Stem the Mounting Federal Debt," December 2009; National Research Council and National Academy of Public Administration, "Choosing the Nation's Fiscal Future," January 2010.

ment debt exceeds 90 percent of GDP.[3] The NAS-NAPA report acknowledges this, stating that "There is no magic number for the ratio of government debt to GDP * * *"[4]

The Pew-Peterson and NAS-NAPA reports both cite the fact that the Maastricht Treaty set a debt-to-GDP ratio of 60 percent as a criterion for membership in the European Monetary Union. They do not cite evidence or economic analysis that supported the EMU's choice of that target, and they discuss neither the role of European politics in the choice of the target nor the criticism of the target in the economics literature as being arbitrary.[5] Nor do they present any arguments to show why a criterion that was deemed appropriate as a condition for entry into the EMU in 1991 should be applied in the United States in the decades after 2010. The reports also do not address whether, even if that target might have been appropriate in 1991, it would still be appropriate today in light of the dramatic increases in government debt resulting from what has in many ways been the worst financial and economic crisis since the Great Depression.

The two reports correctly note that the International Monetary Fund also has used a 60 percent debt-to-GDP ratio target in its analyses of fiscal sustainability, but IMF staff have been clear that the criterion is arbitrary, noting "On why we picked 60 percent, of course, there [is] no magic number, and that's sort of just an illustrative number. * * * Again, these are not targets. These are not ideal numbers. There's no rule that says that it's only sustainable if it's above or below 60."[6] In fact, IMF staff have recently suggested that in light of recent increases in debt, the date for achieving the target should be relaxed—allowing advanced countries that exceed the target in 2014 to gradually reduce the ratio over 15 years, reaching 60 percent by 2029.[7]

We believe Congress and the President should focus on bringing deficits down to about 3 percent of GDP in the years ahead and then keeping average deficits no higher than that level. Under one reasonable path, this would require average deficit reductions of nearly $400 billion in years 2013 through 2018. That would achieve the necessary condition for budget sustainability of stabilizing the debt-to-GDP ratio (the debt would be stabilized at modestly above 70 percent). Aiming to go further may actually have the unintended effect of making it harder to enact needed deficit-reduction legislation, by making the standard for success one that requires budget cuts and tax increases of such severity that they are unacceptable politically. (It also would increase the likelihood that deficit-reduction efforts—if successful—would seriously undercut programs that provide crucial services and benefits to millions of Americans, in which case the savings likely would not endure.)

History clearly shows that overly ambitious budget goals can be counterproductive. For instance, the overly ambitious Gramm-Rudman-Hollings balanced budget target almost certainly contributed to the decisions of President Reagan and the Congress in the mid- to late-1980s to focus more on rosy economic assumptions that made it appear the targets would be achieved rather than on making real progress in reducing the deficit. The House of Representatives also clearly understood the problem of too-ambitious goals last year when it adopted a statutory pay-as-you-go rule that did not require the extension of middle-class tax cuts and other expiring current policies to be paid for. Adopting a strict rule that required any change in law to be paid for would ensure that the rule would be waived multiple times. That would undercut the rule's effectiveness in constraining any costly proposal with significant political support.

SECURING SAVINGS OVER THE COMING DECADE

One of the reasons we believe that the goal of holding debt to no more than 60 percent of GDP by the end of the decade is likely to be politically unfeasible is that very large savings in Social Security, Medicare (beyond the savings in the health

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[3] See Reinhart and Rogoff, "Growth in a Time of Debt," available at *http://www.aeaweb.org/aea/conference/program/retrieve.php?pdfid=416, forthcoming in American Economic Review, Vol. 100 No. 2, May 2010.*

[4] Choosing the Nation's Fiscal Future, p. 3.

[5] For instance, Willem Buiter has written that "The Maastricht deficit and debt criteria were arbitrary and neither necessary nor sufficient for national fiscal-financial sustainability." In "The 'Sense and Nonsense of Maastricht' revisited: What have we learnt about stabilization in the EMU?" *http://www.nber.org/?wbuiter/sense.pdf*

[6] See "Transcript of a Conference Call with IMF Senior Staffs on the Launch of The State of Public Finances: A Cross-Country Fiscal Monitor," July 30, 2009, in which an IMF staff member responds to a question about the 60 percent criterion. *http://www.imf.org/external/np/tr/2009/tr073009a.htm*

[7] See IMF, The State of Public Finances: A Cross-Country Fiscal Monitor, July 30, 2009, p. 18.

reform legislation), and Medicaid will be extremely difficult to achieve over the next decade

Most experts agree that we cannot hold the growth of Medicare and Medicaid costs over time below the growth of private-sector health costs. Since the public and private sectors use the same health providers and the same treatments, holding growth in the public sector to a much lower rate than growth in the private sector would lead either to rationing of health care by income or, more likely, to a substantial shift of costs to the private sector as providers raise prices for privately insured patients to compensate for lower public-sector reimbursements.

Efforts to reduce the growth of health care spending system-wide (both public and private) are the key to reducing Medicare and Medicaid costs in a sensible, compassionate, and sustainable manner. (It is important also to remember that rising health care costs not only raise federal spending directly but also increase deficits by lowering tax revenues below what they otherwise would be. Health insurance benefits provided by employers are exempt from tax, and when health care costs grow faster than the economy, the share of compensation that is exempt from taxation rises and the revenue base consequently shrinks.) Provisions included in the health reform bills passed by the House and Senate—including steps to begin changing Medicare reimbursement policies in ways that could serve as a blueprint for private-sector changes that would improve the efficiency of the health care system as a whole—represent a crucial first step in the effort to slow system-wide cost growth. But, it will take time and further changes in the health system—based on knowledge that we gain in coming years but do not yet possess on how to achieve greater economies in health care without jeopardizing health care quality—to achieve the degree of reduction in the growth of health care costs that we ultimately will need to extract the required savings from Medicare. (I should add that because increases in health care costs are due to a substantial degree to advances in medical technology, many of which improve health and prolong life, it almost certainly will not be possible—or desirable—even in the longer run to slow the growth of health care costs so much that it is no greater than the rate of economic growth.)

Similarly, while there are sensible ways to achieve savings in Social Security, there are limits to how large those savings can be—especially over the next ten years—without undercutting the crucial role of Social Security in reducing poverty and ensuring a decent life for people who are elderly or have disabilities. Social Security benefits under current policies are not as generous as some people assume. Social Security checks now replace about 39 percent of an average worker's pre-retirement wages, less than similar programs in other Western countries. And because of the currently scheduled increase in the "normal retirement age" (which operates as an across-the-board benefit reduction) and the projected growth in Medicare premiums (which are deducted from Social Security checks), that figure will gradually fall from 39 percent to about 32 percent over the next two decades under current law.[8] In addition, recent losses in 401(k) and other retirement plans that supplement Social Security make it all the more important to ensure that Social Security benefits are maintained at an adequate level. Furthermore, the changes in Social Security benefits that can be made without undercutting the goals of the program will need to be phased in gradually—as has been the case with the increase in the normal retirement age that was enacted in 1983 and is still being phased in—so that savings will be small to start with but grow over time.

This means that while the largest share of the savings required over the long term will need to come from reductions in health care expenditures, much of the savings needed to stabilize deficits at no more than 3 percent of GDP by the end of this decade will have to come from increases in revenues and cuts in a wide array of smaller programs (i.e., programs other than Medicare, Medicaid, and Social Security), each of which can contribute only a small amount to the effort. There is clearly a political limit to what can be achieved in these areas.

It should be noted that CBO's projections for the coming decade, our analyses, and budget data from recent years indicate that expenditures for programs other than Medicare, Medicaid, and Social Security—including entitlement programs other than the "big three"—will grow more slowly than GDP in the decades ahead. These programs consequently are not contributing to the long-term fiscal problem. For this reason, statements that we face a general "entitlement crisis" are mistaken. This does not mean, however, that programs other than the "big three" should not be scrutinized for potential savings; they clearly should be.

[8] Virginia P. Reno and Joni Lavery, "Fixing Social Security: Adequate Benefits, Adequate Financing," National Academy of Social Insurance, October 2009.

BEYOND THE COMING DECADE

If deficits are stabilized in the coming decade, Congress and the President can then consider next steps—whether the benefits of further reducing the debt-to-GDP ratio to 60 percent (or less) would more than offset any harm that the additional budget cuts and/or tax increases needed to achieve that reduction might involve. But it does not make sense to set a target today that is not necessary to achieve budget sustainability—and that is politically so difficult to meet that it would make continued inaction more likely. Instead, we should set a target that is ambitious and strong, but not so intensely excruciating as to be virtually impossible to attain.

Chairman SPRATT. Thank you, Bob.

Mr. Capretta?

STATEMENT OF JAMES C. CAPRETTA

Mr. CAPRETTA. Good morning, Mr. Chairman, Mr. Ryan, and other members of the committee. Thank you for the opportunity to participate in this very important hearing on the Nation's long-term budget outlook.

It is readily apparent that the Federal budget is on an unsustainable path. You have already heard quite a bit about that. From 1789 to 2008, the Nation accumulated $5.8 trillion in debt. According to the Congressional Budget Office, President Obama's 2010 budget plan would push the Nation's debt above $17 trillion by 2019. That is more than tripling what the government owes to lenders in just 11 years.

Moreover, this rapid run-up in debt would occur just as the Nation is entering into a period of dramatic demographic transformation. In our latest long-run cost projections, CBO expects spending on the three main entitlement programs—Social Security, Medicare, and Medicaid—to rise from 9.8 percent of GDP in 2010 to 14.4 percent in 2030, or an increase of about 4.6 percent of GDP in 20 years. To put that in perspective, that is like adding another program of the size of Social Security to the Federal budget over a period of two decades without any additional revenue to pay for it.

The President has correctly argued that rising health-care costs, along with the aging of the population, is at the heart of the medium- and long-term budget problem. But there are many reasons why those who are concerned about the Nation's long-term finances should be very concerned about the budgetary implications of the health-care bills now under consideration in Congress. Let me outline just a few of these reasons.

First, Medicare physician fees. Both the President and congressional leaders have signaled that they will not allow a 21 percent reduction in Medicare physician fees to go into effect in 2010 or later years.

The original version of the House health-care legislation, released in July, included a permanent repeal of the planned fee cuts at a cost of $229 billion over 10 years. However, after the President announced a $900 billion limit on total spending in the bill, House leaders decided to drop this provision from the larger health-care legislation and pass it as a separate bill. Senate leaders then followed a similar course.

Of course, passing it separately does not change its cost. It is still $200 billion in spending that must be either offset or borrowed from lenders, and it doesn't matter if the health-care effort is passed in one bill or two; the total cost is the same either way.

When a fix for physician fees is properly included in the total cost of what is being planned, both the House and Senate bills would flip from modestly reducing the Federal budget deficit over the next decade to increasing it by about $80 billion.

Two, substantial noncoverage spending in the bills. In September, the President said he wanted the bills to spend no more than $900 billion over 10 years. He didn't say that was for a net number, with tax increases offsetting part of the cost. Nor did he say it was a limit only for some of the spending in the health-care bill. And yet, when all the spending is included in a proper rack-up, both the House- and Senate-passed bills would far exceed the $900 billion limit the President himself has established.

In the House bill, the gross cost of the Medicaid expansions and the entitlement to new premium subsidies in the exchange would cost $1.055 trillion over 10 years, according to CBO. In addition, the House legislation includes scores of other spending provisions, from everything from special payments to U.S. territories to Medicaid expansions.

According to CBO, these provisions would cost about $230 billion more over the next decade. Add $210 billion for a physician fee fix, and the cost of the House health-care effort reaches nearly $1.5 trillion between 2010 and 2019. The Senate plan's total cost approaches $1.2 trillion.

Three, unrealistic Medicare cuts. There has been a great deal of discussion about reforming health-care delivery to painlessly root out unnecessary costs. But the bills as passed by the House and the Senate do not achieve any substantial savings with these kinds of provisions. Instead, they achieve the bulk of Medicare savings, which totals $467 billion over 10 years in the Senate bill, from across-the-board payment rate reductions, including an automatic yearly cut in the inflation update for certain providers of care.

The chief actuary of the Medicare program has warned that these arbitrary reductions could have serious consequences for beneficiaries' access to care, as they would push about one out of every five hospital facilities into insolvency. And yet, despite this warning, the House and Senate bills assume these cuts would continue in perpetuity and provide the offsetting savings needed for rapidly growing entitlement expansions.

Number four, the CLASS Act. Both the House and Senate bills would stand up an entirely new entitlement program for long-term care services called the Community Living Assistance Services and Supports Act, or CLASS Act. Eligible participants would be required to pay premiums in advance of receiving any benefit payments. Consequently, starting this new program from scratch would produce one-time savings inside the budget window from premium collections before any cohort of beneficiaries starts drawing benefits.

But the premiums collected in the early years would also be needed to liquidate entitlement obligations later outside the 10-year budget window. So, in a very real sense, the CLASS Act premiums are being double-counted. They are being used to pay for the health-care bill as well as deposited into an account to pay future long-term care benefits. If these premiums were only counted once, the 10-year deficit increase associated with the House-passed bill would go up by another $100 billion.

Five, the true 10-year window. Although the House and Senate sponsors of the health-care bills argue that expeditious enactment is necessary, the key provisions to expand coverage would not go into effect until 2013 in the House bill and 2014 in the Senate bill. But the spending cuts and tax increases would kick in much earlier. Looking at these bills over a true 10-year window of full implementation reveals much higher costs. The Senate bill's provisions, even excluding the Medicare physician fee fix, would total $2.3 trillion over the period 2014 to 2023. The House bill's true 10-year cost would be of comparable magnitude.

Six, the certainty of future entitlement expansions. Both the House and Senate bills assume the cost of the new entitlement spending coverage expansion can be held down with provisions which lock workers into employer-sponsored plans. If an employer offers qualified insurance to a worker, the employee really has no choice but to take it if he wants to avoid paying the penalty for going uninsured. They could not go into the so-called exchanges to get insurance subsidies with Federal tax support.

These firewall rules would create large disparities in the Federal subsidies made available to workers inside and outside the exchanges. According to Gene Steuerle of the Urban Institute, a family of four with an income of $60,000 with employer-sponsored health care would get about $4,000 less in Federal support in the House bill outside the exchange than a similar family inside the exchange would get in 2016.

And there would be many tens of millions more families outside the exchange than in it. According to CBO, today there are about 127 million Americans under the age of 65 with incomes between 100 and 400 percent of the Federal poverty line. But CBO expects only about 18 million people will be getting exchange subsidies in 2016.

If enacted as currently written, pressures would build very quickly to treat all Americans fairly regardless of where they get their insurance. One way or another, the subsidies provided to those in the exchanges would be made more widely available, driving the cost of reform much higher than estimates currently indicate.

Number seven, weak cost-control mechanisms. It has been argued by some that the bills include strong cost-control mechanisms which will slow the pace of rising costs even more than CBO currently estimates. That seems highly unlikely, however, given the compromises which have been made to get these provisions into the bills.

For instance, many point to the so-called high-cost insurance tax in the Senate bill as a potentially important cost-control provision. But, in recent days, the White House announced an agreement with some of the Nation's leading labor unions to exempt all collectively bargained plans and State and local government workers from the excise tax through 2017. News reports indicate that this deal would reduce the revenue collected from this provision by 40 percent.

But it seems much more likely that it would lead to a wholesale abandonment of the idea because of the inequities it would create. In effect, all non-union workers in the private sector would be potentially subject to the tax for a full 5 years before unionized workers were. That will strike many Americans as patently unfair. If enacted, pressure would surely build on Congress to make the exemption available to all workers, thus gutting the provision altogether.

Similarly, the Senate bill also includes an independent Medicare commission which could make recommendations to reduce Medicare payments to providers. And those recommendations would go automatically into effect if Congress did not act to pass provisions of the similar magnitude.

Sponsors of the legislation have argued that this commission would help bend the cost curve. But the commission's mandate would be very limited. It could not make any recommendations which altered any aspect of insurance coverage for beneficiaries or reduce their hospital or physician spending through 2019. That doesn't leave a lot of room to implement meaningful changes which have a large impact on cost. Moreover, pressure would build to extend indefinitely the exemptions for hospitals and physicians and to make it available to other providers of Medicare-covered services, as well.

Let me conclude. The Nation's long-term budget outlook is bleak, in large part because our health-care entitlement commitments far exceed the revenues available to pay for them. By 2019, the House- and Senate-passed health-care bills would add to these commitments by another $200 billion per year, and that commitment would grow, as CBO has told us, 8 percent annually thereafter. Moreover, the bills would unleash pressures for even more spending down the road. Meanwhile, the offsets used to pay for this spending would be much less likely to occur, and the cost-control provisions are not nearly robust enough to make a difference.

Congress would be well-advised to take a step back and rethink this entire approach. Instead of passing an expensive health-care bill that uses $1 trillion in offsets to pay for more spending, it would be better to craft a sensible, consensus, long-term budget plan first which has as one of its core elements an affordable, bipartisan health-care program, one that truly does the job on costs and expands coverage as well.

Thank you.

[The prepared statement of James Capretta follows:]

PREPARED STATEMENT OF JAMES C. CAPRETTA, FELLOW, ETHICS AND PUBLIC POLICY CENTER

Mr. Chairman, Mr. Ryan, and other members of the Committee, thank you for the opportunity to participate in this very important hearing on the nation's long-term budget outlook.

It is readily apparent that the federal budget is on an unsustainable path. From 1789 to 2008, the nation accumulated $5.8 trillion in debt. According to the Congressional Budget Office (CBO), President Obama's 2010 budget plan would push the nation's debt above $17 trillion by 2019—thus more than tripling what the government owes to lenders in just eleven years.

Moreover, this rapid run-up in debt would occur just as the nation is entering into a period of dramatic demographic transformation. Between 2010 and 2030, the population age 65 and older will rise from about 41 million to 71 million, which will drive up spending on the nation's three largest entitlement programs—Social Security, Medicare, and Medicaid. In their latest long-run projections, CBO expects spending on just these three programs to rise from 9.8 percent of GDP in 2010 to 14.4 percent in 2030, or an increase of about 4.6 percent of GDP in twenty years. To put that in perspective, that's like adding another program of the size of Social Security to the federal budget over a period of two decades without any additional revenue to pay for it.

The president has correctly argued that rising health-care costs, along with the aging of the population, is at the heart of the medium and long-term budget problem. And he has also said, repeatedly, that one of the primary objectives of the health-care legislation which has been under consideration in Congress for the last year is to slow the pace of rising health entitlement costs for the federal government.

It is also true that CBO has provided cost estimates which show modest deficit reduction from these bills—as written—over the period 2010 to 2019.

But these cost estimates are based on assumptions that are highly unlikely to hold up over time. Indeed, there are many reasons why those who are concerned about the nation's long-term finances should be very concerned about the budgetary implications of the health-care bills under consideration in Congress.

Let me outline just a few of these reasons.

MEDICARE PHYSICIAN FEES

Both the President and Congressional leaders have signaled that they will not allow a scheduled 21 percent reduction in Medicare physician fees to go into effect in 2010 or later years. The original version of House health care legislation, released in July 2009, included a permanent repeal of the planned fee cuts, at a cost of $229 billion over ten years. However, after the president announced a $900 billion limit on total spending for health-care in September, House leaders decided to drop this provision from the larger health-care legislation and pass it as a separate bill. Senate leaders then followed a similar course.

Both the House and Senate bills are filled with provisions which would make changes in the Medicare program. It is hard to imagine what would justify taking this one change to the program and passing it separately from all the others. Of course, passing it separately does not change its cost. It's still $200 billion in spending that must either be offset or borrowed from lenders, and it doesn't matter if the health-care effort is passed in one or two bills. The total cost is the same either way. When a fix for Medicare physician fees is properly included in the total cost of what is being planned, neither the House nor the Senate version would reduce the federal budget deficit between 2010 and 2019. Indeed, if something like the House version of the fix is including in the accounting, both the House and Senate bills would flip from modestly reducing the federal budget deficit to increasing it by about $80 billion over a decade.

SUBSTANTIAL NON-COVERAGE SPENDING IN THE BILLS

In September, the president said he wanted the bills to spend no more than $900 billion over ten years. He didn't say that was for a "net" number, with tax increases offsetting part of the cost. Nor did he say it was a limit only for some of the spending in the health-care bill.

And, yet, when all of the spending is included in a proper rack up, both the House and the Senate passed bills would far exceed the $900 billion limit the president established for the initiative just a few months ago.

In the House bill, the gross cost of the Medicaid expansions and the entitlement to new premium subsidies in the exchange would cost $1.055 trillion over ten years, according to CBO. In addition, the House legislation includes scores of other spending provisions, for everything from increasing payments to primary care providers to special payments to U.S. territories. According to CBO, these provisions would cost about $230 billion more over a decade. With a $210 billion physician fee bill, the total cost of the House's health care effort reaches nearly $1.5 trillion between 2010 and 2019.

In the Senate legislation, the cost of the coverage expansion is $871 billion between 2010 an 2019. Other spending in the bill totals about $90 billion over ten years. With about $200 billion more for a permanent repeal of the Medicare physician fee cut, the Senate plan's total cost approaches $1.2 trillion.

UNREALISTIC MEDICARE CUTS

There has been a great deal of discussion about reforming health-care delivery to painlessly root out unnecessary costs. But the bills as passed by the House and Senate do not achieve any substantial savings with these kinds of provisions. Instead they achieve the bulk of the Medicare savings, which totals $467 billion over ten years in the Senate bill, from across-the-board payment rate reductions, including an automatic yearly cut in the inflation updates for certain providers of care.

The Chief Actuary of the Medicare program has warned that these arbitrary reductions could have serious consequences for beneficiaries' access to care, as it would push about one out of every five hospital facilities into insolvency.

And, yet, despite this warning, the House and Senate bills assume these cuts would continue in perpetuity and provide the offsetting savings needed for a rapidly growing entitlement expansion.

THE CLASS ACT

Both the House and Senate passed bills would stand up an entirely new entitlement program for long-term care services, called the Community Living Assistance Services and Supports, or CLASS Act. Eligible participants would be required to pay premiums in advance of receiving any benefit payments. Consequently, starting this new program from scratch would produce one-time "savings" from premium collections before any cohort of beneficiaries starts drawing benefits. But the premiums collected in the early years would also be needed to liquidate entitlement obligations later, outside of the ten-year budget window.

So, in a very real sense, the CLASS Act premiums are being double-counted. They are being used to pay for the health-care bill, as well as deposited in an account to pay future long-term care benefits. If these premiums were only counted once, the ten year deficit increase associated with the House-passed bill would go up by more than $100 billion.

THE TRUE TEN-YEAR WINDOW

Although the House and Senate sponsors of the health care bills argue that expeditious enactment is necessary to provide better services to the uninsured, none of the key provisions to expand coverage would go into effect until 2013 in the House bill and 2014 in the Senate bill. Meanwhile, many of the spending reductions, such as the cut in Medicare Advantage payment rates, would kick in much earlier, as would the tax increases. Consequently, both bills have ten years worth of spending and revenue "offsets" paying for only six or seven years worth of spending.

Looking at these bills over a true ten year window of full implementation reveals much higher costs. The Senate bill's provisions, even excluding the Medicare physician fee fix, would total $2.3 trillion over the period 2014 to 2023, with the coverage provisions fully in place. The House bill's true ten-year cost would be of a comparable magnitude.

THE CERTAINTY OF FUTURE OF ENTITLEMENT EXPANSIONS

Both the House and Senate bills assume the new entitlement spending for coverage expansion can be held down with provisions which lock workers into employer-sponsored plans. If an employer offers "qualified" insurance coverage to a worker, the employee really has no choice but to take it if he wants to avoid paying the penalty for going uninsured. They could not go into the so-called "exchanges" to get insurance subsidized with federal tax support.

These firewall rules would create large disparities in the federal subsidies made available to workers inside and outside the exchanges. According to Gene Steuerle of the Urban Institute, a family of four with an income of $60,000 with employer-sponsored health care would get about $4,000 less in federal support in the House bill outside of the exchange than a similar family inside the exchange would get in 2016. And there would be many tens of millions more families outside the exchange than in it, according to CBO. Today, there are about 127 million Americans under the age of 65 with incomes between 100 and 400 percent of the federal poverty line, but CBO expects only about 18 million people will be getting exchange subsidies in 2016.

If enacted as currently written, pressure would build very quickly to treat all Americans fairly, regardless of where they get their insurance. One way or another, the subsidies provided to those in the exchanges would be made more widely available, driving the costs of reform much higher than estimates currently indicate.

WEAK COST-CONTROL MECHANISMS

It has been argued by some that the bills include strong cost-control mechanisms which will slow the pace of rising costs even more than CBO currently estimates. That seems highly unlikely however, given the compromises which have been made to get these provisions into the bills.

For instance, many point to the so-called "high-cost insurance tax" in the Senate bill as a potentially important cost-control provision. But in recent days, the White House announced an agreement with some of the nation's leading labor unions to exempt all collectively bargained plans and state and local government workers from the excise tax through 2017.

News reports indicate that this deal would reduce the revenue collected from this provision by 40 percent. But it seems much more likely that it would lead to a wholesale abandonment of the idea because of the inequities it would create. In effect, all nonunion workers in the private sector would be potentially subject to the tax for a full five years before unionized workers were. That will strike many Americans as patently unfair. If enacted, pressure would build on Congress to make the exemption available to all workers, thus gutting the provision altogether.

Similarly, the Senate bill also includes an independent Medicare commission which could make recommendations to reduce Medicare payments to providers, and those recommendations would automatically go into effect if Congress did not act to pass provisions which would reduce spending by similar amounts. Sponsors of the legislation have argued that this commission would help bend the cost-curve system-wide.

But the commission's mandate would be very limited. It could not make any recommendations which altered any aspect of insurance coverage for beneficiaries, or reduced hospital or physician spending through 2019. That doesn't leave a lot of room to implement meaningful changes which have a large impact on costs. Moreover, pressure would build to extend indefinitely the exemptions for hospitals and physicians, and to make it available to other providers of Medicare-covered services as well.

CONCLUSION

The nation's long-term budget outlook is bleak in large part because our health-care entitlement commitments far exceed the revenues available to pay for them. By 2019, the House and Senate-passed health-care bills would add at least another $200 billion per year to those commitments, and unleash pressures for even more spending down the road. Meanwhile, the offsets used to pay this spending would be much less likely to occur, and the cost control provisions are not nearly robust enough to make a difference.

Congress would be well-advised to take a step back and rethink this entire approach. Instead of passing an expensive health-care bill that uses $1 trillion in offsets to pay for more spending, it would be better to craft a sensible, consensus long-term budget plan which has as one of its core elements an affordable, bipartisan health-care program, one that truly does the job on costs and expands coverage as well.

Chairman SPRATT. Each of you has referred to the idea of a deficit commission. I think you know the state of play right now; it appears there may not be the votes to pass the deficit commission by statute in the Senate. So the alternative of a Presidential executive order is being weighed and perhaps written at this point in time.

Do you think that is a feasible approach to the problem? And are their process changes you would recommend to go along with that?

We will start with you, Mr. Podesta.

Mr. PODESTA. Well, Mr. Chairman, I would note that the Republican leadership in the Congress seems to have already rejected the proposal that the President has put forward to create a bipartisan commission. I think that the structure of the commission that has been noted in the newspapers, which would require a super-majority vote, including the Republican appointees to the commission, gives some potential hope that you could find some bipartisan compromise on this question.

I think if you look back at a couple of commissions in recent history, the so-called Greenspan Commission on Social Security, it really took the political will at the top level in both parties, President Reagan and Tip O'Neill, to really bring that commission to a result that mattered. Bob Ball's recent posthumously published comments on that, I think, are instructive on that.

And if you take a look at another more recent commission that President Bush appointed that was chaired by Senators Breaux and Connie Mack on taxes, that commission was sort of dead on arrival because I think it didn't have the support from even the people that appointed it, including President Bush. So, really, it is going to take, I think, a structure that builds in a result in which both parties participate, and it is going to require political will.

And then, finally, I would say, as I said in my opening statement, that it is going to require one other thing, which is that if you just sort of charge this commission with saying, "We have a big problem; try to figure it out," I don't think that is a recipe for success. It really needs a target that it needs to hit, in which case then I think people can debate what the best way to get to those targets are.

Chairman SPRATT. Ms. MacGuineas?

Ms. MACGUINEAS. Yes, so——

Chairman SPRATT. Well, let me ask one additional question of each of you. If you are proposing entitlement—would you propose just entitlement reform, or would you each apply the idea of a commission, by whatever source of authority, to include everything with deficit-reduction goals, as you put it, Mr. Podesta?

Mr. PODESTA. As I noted, I would say that was critical. And I think there is a fair amount of agreement, at least amongst the three of us on this side of the table, that having a goal of stabilizing the debt-to-GDP ratio—we go further in the out-years and try to achieve a real balanced budget, which would begin to reduce the debt-to-GDP ratio. I think those are the metrics of success. And doing that across the platform of the entire Federal budget and the Federal Government is more likely to be successful than just narrowing this to a Social Security commission or, if health care stalls, a Medicare commission.

Chairman SPRATT. Ms. MacGuineas?

Ms. MACGUINEAS. So, I would describe myself as kind of a Johnny-come-lately to the whole commission bandwagon. For a long time, I really did stick with the notion that Congress should just do its job and that outsourcing this was unnecessary. However, as time has marched on and we haven't made any progress, I have come to believe that a commission is the right way to go, if there is congressional buy-in. It is never going to work if people don't buy into it.

I felt that, with a statutory commission, there was a good chance of that moving forward. And I have been hoping that we would see progress on that. And I was hoping that the White House would lend its support to a statutory commission to move that forward. It looks like that is not going to happen. So the question is, how do you feel about an executive commission? Clearly, the bipartisan political will on this is breaking down, or has broken down.

And I see the arguments on both sides. I can see a strong argument that this is more about political cover than really doing anything. I can also see that it is critically important to have some mechanism in place. It is not impossible that we have a fiscal crisis this year. And it really concerns me that, if there is no mechanism to be moving forward on it, what are we going to do?

So would I like to have that commission there working on the problem? Absolutely. But if there is not bipartisan buy-in, we know that it is not going to work, and there are risks that it could backfire. Oftentimes in policy, we see that when the best specific ideas get put on the table too early and one party sort of brings them out, the other party beats up on them, and you kind of toxify what should be the policy decisions that we are talking about.

So if people aren't going to support it, no, we shouldn't go forward. But I would say to anybody who is not supporting an executive commission, then what? What are we going to do? What kind of fiscal goal are we going to commit to? What kind of budget is this committee going to be able to put forward? We can't just have the answer be nothing.

So, in terms of the second question, if it were a commission what would I suggest, I certainly am somebody who says "everything on the table." The way I look at this problem, you can tell I am kind of a squishy center independent because I see both sides of all these issues.

But the problem, if you look at the numbers, it is a spending problem. There is not a question that the growth in the budget is on the spending side. However, if you sit down and you try to come up with a plan to achieve a reasonable fiscal goal, as we did over months, I don't see how you do it without increasing revenues. I don't think it should be the biggest part of a plan, but I think it is going to have to be part of the plan. Anyhow, I welcome anybody who can show how you do it on either side of budget, just through revenues or just through spending. I think you start with everything on the table.

But then again, I will also back up and say, if we can't get buy-in for a commission, maybe we should start smaller and just focus on something like Social Security reform. Really, my bottom line is: Whatever works. We have to do something. And the world is watching, and if they see us not moving and failing at anything we try, that is going to be a terrible signal to send.

Chairman SPRATT. Mr. Greenstein?

Mr. GREENSTEIN. Well, the commission question is one I have a long interest in, having been a commissioner the last time we had a deficit-reduction commission, the Kerry-Danforth Commission in 1994. Obviously, that commission did not succeed.

Commissions are no panacea. In the right circumstances, they can be useful. I am in agreement with virtually everything John said and much of what Maya said, as well.

I have been frustrated by the recent debate on the commission because it has focused on the wrong questions, in my view. It is focused on, should it be statutory or can the President support it, and does it need a fast track?

Let's look at the Greenspan Commission. It was not statutory; it was appointed by President Reagan. It did not have a fast track. And, in fact, you will find that what the Greenspan Commission brought out closed two-thirds, not all, of the 75-year gap under the projections at the time, and the Congress actually bit the bullet and put the additional changes in. It went beyond the commission to do the 75-year solvency under the projections that were used at the time.

The other thing one should note about the Greenspan Commission is it started from an agreement from both parties that both benefits and revenues would be on the table as part of the discussion there.

I don't understand the argument that, if there is a statutory commission, it will have a much greater chance of success than if there is a presidentially appointed commission. In fact, I think, if anything, it is probably a little on the other side. And the reason I say that is, with all due respect to Members, if you had a commission that was Members only of 18, hard for me to see 14 of 18 agreeing to a package that has both spending and revenues in it.

I actually kind of like the idea of having some former Members, who aren't facing the voters again and aren't facing primary challenges from the wings of their party, seeing if they can at least get the ball started by coming up with some things covering both spending and taxes that they can agree upon.

And I actually think that—and the Greenspan Commission is instructive here—that the idea of a fast track, where you are not allowed to do amendments, is counterproductive. It would reduce the chances that whatever a commission came up with could pass. Think of any piece of legislation most of time that is controversial, that involves hard choices, that gores some oxes, that you work on, either party, you often have to make adjustments at the end to get those final votes to get over the top. If you were moving a major piece of legislation and you denied yourself the ability to adjust anything to get over the top, the chances that you wouldn't get the votes to pass it would go up.

So I am really baffled by this idea that if it is statutory and you can't amend it, it would succeed, but if the President appoints it and it doesn't have a prohibition on amendments, it would fail. I think, if anything, the evidence, particularly looking at the Greenspan experience, goes the other way.

The final point is the one John made and Maya also made, which is the most important of all. The other thing we learned from Greenspan and from Bob Ball's amazing chapter on the commission, which I recommend everyone read, is that the commission had initially failed to reach agreement. And what then happened was, through their representatives, President Reagan and Tip O'Neill said, let's go, sort of, just take a sub-group, about five members of the commission, and see if they can work out an agreement, putting everything on the table, on Social Security. They worked out an agreement and brought it back to the commission, which then ratified it and took it to the Hill, which then actually enlarged it and passed it.

The moral of the story is, if the leaders of both parties don't want a commission to succeed, if the leaders of both parties aren't willing to put both parts of the budget, taxes and spending, on the table, the chances that it is going to have a successful outcome are going to be low. But if the leaders of both parties are willing to do that and want to use a commission as a mechanism to make progress, then it can be a useful mechanism.

Chairman SPRATT. Thanks, Bob.

Mr. Capretta?

Mr. CAPRETTA. Yes, I guess I am somewhat agnostic about commissions. I think context is crucial. And I am somewhat concerned that the environment today is not going to be particularly conducive to a successful launch of a commission.

I think it is going to look and feel to a lot of people like, especially with regard to the health-care effort, that here we are in the middle of a bruising and very polarizing battle about what to do about health care in the United States that has very dramatic implications for the Federal budget and the long-term budget, and so it looks and feels a little bit like, let's lock in this big program and then, after the fact, come back and have a commission to try to get our budget in order. And I think if that is the way this proceeds, that will look to a lot of people as just backwards. In other words, you know, if you want to draw in both sides to have a sensible budget plan, it ought to incorporate a sensible health-care plan and not the other way around.

And so, I think that is why right now there is great instability around the notion of drawing a bipartisan commission together, because we are in the midst of a very intense struggle over what to do about health care, which has big implications for this.

Chairman SPRATT. Mr. Ryan.

Mr. RYAN. Ms. MacGuineas, I will start with you because I want you to know we all do like you and respect you. How about let's go into debt. I am looking at historical tables here. You know, our debt per GDP kind of ranged in the 40s, and the 30s in the 1990s and the beginning part of this decade, and then because of the crisis and all of these other things, we are up in the 60s. The CBO's most recent estimate, which is, I think, their July or August baseline, you know, puts the debt right now at 64.9, 65 percent. And then we close the budget window at 82 percent. So you are saying we should get to 60 and then stay there and get down from there. Obviously, no one has a disagreement with that. How do you propose doing it? And you mentioned you'd be happy to throw some specifics out there. Let me just throw you the line there. How would you get at 60 and stay there and get below and what specifics would you do?

Ms. MACGUINEAS. Okay. Well that is a very easy question. Thank you, Congressman Ryan. This should be no problem. Here's a budget blueprint. It is an appendix to our report because it is not a set of policies that our commissioners support.

Mr. RYAN. Is this the Red Ink Rising report you are talking about?

Ms. MACGUINEAS. Yes, it is.

Mr. RYAN. Yeah, that came up with procedural devices, right?

Ms. MACGUINEAS. Yes it did, but we also have an appendix that is on the Web site that shows, illustrates what it would take to get there because I think it is very important if you are going to say this is what you want to do, to show the kinds of policies it would require.

So that is why I have wrestled with these numbers for quite some time. And let me tell you, you have to do everything to get there. So I will just tick through these things, and anybody whose interested in looking at it, I am sorry I didn't bring it, it is on our

Commission Web site, and I will actually send it to the committee. But we talk about every area of the budget specifically. We recommend that in defense you reduce certain weapons systems, you get rid of—I am sorry—that would save about $100 billion a year, outdated programs, discretionary spending caps which can save a remarkable amount of money. We actually focus so much on mandatory spending at our group and in the budget committee, you can save a lot of money from discretionary spending caps, and I think we have to take those seriously in the coming years.

Agriculture, everybody, who, I guess, is not a member, but every budget wonk's favorite thing to point out. And then you move on to Social Security. I would specifically, and I actually came out a couple of years ago with two colleagues, a Republican and a Democrat, with a bipartisan Social Security plan. The types of things we recommended are speed up the increase in the retirement age and increase it a little bit further and index it. Slow the growth of benefits on the high end.

Mr. RYAN. What kind of indexes, progressive indexing you are talking about?

Ms. MACGUINEAS. We did, not quite as much as progressive indexing, and we don't call it that because that is one of those good ideas that had become toxic, so you learn that you have to rename good ideas something else. But you slow the growth at the high end, right? You guys know how to do that.

Mr. RYAN. I don't think the progressives like us calling it progressive indexing.

Ms. MACGUINEAS. I think it is a very good idea. I think you want to protect the people at the low end of Social Security, and you want to scale back benefits for people who can afford it. Overall, and again I need to clarify, I am not talking for the Committee for Responsible Budget. My own view is you can reduce benefits for people across the board, or you can reduce them for people who need them less. I think means testing is something that needs to be in the discussion a whole lot more than it is currently. Slowing the growth of benefits for Social Security, increasing the premiums for Medicare for folks. I always get angry calls from my father right after I testify or talk about these ideas, but they need to be part of the discussion. And you need to be protecting the low end where people really rely on these programs. When it comes to health care, we are going to have to do more than is in the current health care bills. I was very optimistic about the notion of bringing in all the things that would gradually slow the growth of health care, but it is not surprising that much of that which is hard has gotten watered down, and we are going to have to go, I don't think anybody questions this anymore, farther than the current health care reforms would be able to get at some of the real problems in the budget.

On tax policy, I think a great place to start is looking at the tax base. We have almost $1 trillion a year in tax expenditures. These are very inefficient ways to basically spend through the tax code and I think reforming tax expenditures is very necessary. There are certain ones that should possibly be removed, deduction for State and local taxes for instance, there are things that should be capped, the home mortgage interest deduction, another one that is tough to talk about in polite circles, but is not a great policy, and the health care tax expenditures, tax exclusion should be looked at.

Even that is got going to get you far enough. I don't think we can go blindly and extend all the tax cuts. I think we need to think about whether that is the right policy and if so, how we would offset those costs. I believe an energy tax is something that we should be looking at, and then something that hits both sides of the budget is changing the way we do indexing, moving to the superlative CPI, which is the kind of thing that would both have a change in the tax brackets and slow the growth of benefits on a lot of things.

So basically, you have to go through the budget. You have to include everything. There are a lot of other policies that I think should actually reform budget priorities. I think the way that we tax is not conducive with economic growth. I think we want to look at things like shifting towards consumption bases, reforming the corporate income tax, but I don't think we can talk about doing these in any way other than that is revenue enhancing. When we have done tax reform before it has been revenue neutral.

Now I think we have to focus on economic growth and a better Tax Code, but we are going to have to raise more money. On the spending side of the budget, I think we spend way too much on consumption and not enough on investment, so I would shift a lot of spending priorities more towards things with higher returns. So that is probably a much longer list than you even wanted, but I do feel an obligation for all of us on the side who sit there and talk about how important this stuff is to show and illustrate it is not easy. Everybody's ox is going to get gored, and that, you know, no matter how much we can come up with specifics, we will probably need to do more. But we have to be realistic about the magnitude of the problem.

Mr. RYAN. Adding those up in my mind, that still doesn't do it. But they are obviously good big ideas. But do those things, using the conventional scoring, get you to 60 and go down?

Ms. MACGUINEAS. Indeed they do. I will send this to the whole committee.

Mr. RYAN. Mr. Capretta, because I want to be careful of my time here. There is no question that our fiscal future is tied to health care. Everybody understands that. Everybody on the panel would agree with that. You have done a very good job of exposing sort of the true costs of this particular bill, what it really costs when reality is applied to the analysis. And I would be happy to debate anybody on that. But this bends the curve up, not down, and I know you would agree with it, but the question is could we do health care reform that actually achieves the objective we want to achieve, meaning more access to affordable health care, you know, for people with preexisting conditions, achieving the objectives of insuring the uninsured. Could we do that while also doing a good job on the budget, while also advancing our concerns and our goals of reducing health care as a percentage of GDP, the debt as a percentage of GDP and literally bending the cost curve down, not up? Is there a way to do that while also advancing the priorities of health care reform and the priorities of budget balance?

Mr. CAPRETTA. I think the answer is yes, although we do need to approach this whole subject with a certain amount of humility.

It is a vast health care system, very complicated, and the idea that we are going to, in one idea enacted in one year, fix whatever problems we perceive in perpetuity is unrealistic, so we are going to be at this for a while. Now, having said that, I think the central question, CBO has testified a number of times to this committee and other committees over the last 4 or 5 years that there is a vast amount of waste in the health care system. And I think lots of people agree with that. There is care that is provided that is not needed or too costly or there are errors, the quality isn't as high as it could be. So there are ways to improve the productivity of the health care system. Indeed, that is really the central question in the whole debate.

Mr. RYAN. Such as?

Mr. CAPRETTA. Well, let me get to this. I mean, what process—we are not going to be able to decide right now how to do it from Washington, how to practice medicine out in the United States. But what we do, what we need to do is decide what process has the best chance of driving out unnecessary and inefficient care? What process will drive up the productivity of how physicians and hospitals actually care for patients, and the quality as well? That is really the question. What process, because we are not going to make all the decisions all at once. You have to set up a process that will continually do this, drive productivity every year. And the bills, as currently written, you know, for maybe sometimes good reasons, lean very heavily toward a governmental process that essentially the Federal Government will lead a research effort, will use Medicare payment policy, will try to drive a regulatory policy to get out unnecessary care.

I find that incredibly—it is unrealistic from my point of view that that will ever work. In fact, if you look at the history of the Medicare program, what happens when we try to use a governmental process to drive cost control, the government ends up just applying across-the-board payment cuts because it is very difficult for the political system to pick winners and losers in the health care system, and say you are not providing good care, so therefore you are not going to get paid anymore.

Those are the kinds of tough decisions you have to do to drive out unnecessary costs. But the political system cannot do that easily at all.

Mr. RYAN. And even with all that Medicare grows at faster than 7 percent.

Mr. CAPRETTA. That is correct, because of volume. So what we do through the political process is we apply arbitrary across-the-board cuts to every licensed provider whether or not they are providing high quality care or not. I find that to be exactly the wrong way to go about this. What we need to do is much more like an FEHB-type system or a Medicare part D type system where the government is providing important oversight and consumer protections, but the resource allocation decisions are made decentrally by consumers and the suppliers of services. I don't think that the innovations that are necessary to make our health system more productive and less costly are going to come from Washington. It is going to actually come from physicians and hospitals practicing medicine around the country.

So my recommendation would be to focus on ways of reforming our entitlement policy and tax policy to move control back more toward the beneficiaries and consumers, much like your road map actually recommended.

Mr. RYAN. Thanks for the plug. I have lots of questions, but in concern of the time I will ask them later.

Chairman SPRATT. Thank you, Mr. Ryan. Ms. Schwartz.

Ms. SCHWARTZ. Thank you very much. And I first want to start by thanking our chairman for having this hearing. As we begin the budget process, and of course, we will hear from the President on a proposed budget for this year, our understanding of the seriousness and our commitment to understanding and then being able to deal with the seriousness of the debt we are in, and of course, the annual deficit is something that this committee has taken seriously, and I thank the chairman for giving us some time to focus on it.

I also want to thank the panelists for not only explaining some of it but also giving us some ideas about how to move forward because otherwise it is pretty daunting. I did want to just very briefly really be clear about how we got into this because as Democrats, in particular, we take seriously this deficit and we want to deal with it and we want to act fiscally responsibly. But we also want to understand how we got here, and if we don't understand that, we won't be able to look forward further. I particularly wanted to say that we have been in this situation not as bad but we have been in this situation before. I am going to ask Mr. Podesta to speak about this because he was very involved when President Clinton came into office. We have been in this situation before.

We have inherited a deep debt and a budget that didn't and fiscal policies that actually were not sustainable, simply not having enough revenue to meet our obligations and relying on borrowing. And we are in a much worse situation than we have been ever before, both because we now are keenly relying on borrowing to just sustain our annual budget at all. It is almost, this year we are up to 40 percent of our revenues come from borrowing. And under the Bush administration, doubled borrowing. And I think we have some charts on this. I don't always rely on charts but I know we have some where under the Bush administration we relied on borrowing, we doubled it from $3.4 trillion to $6.3 trillion, and almost all of that is foreign borrowing.

And I think that as Ms. MacGuineas mentioned, that that is a huge cost and a risk because they can increase those interest rates and they can also stop lending to us and all of that is really very, very risky. We are now spending about 5 percent of our spending, our expenditures go to debt interest payments. Now any American family can understand this. If you are borrowing way more than you should and you are paying interest rates, even when we are paying low interest rates, it is a huge problem for us going forward. So our commitment is clear but we should also understand that we have inherited a deep debt. We have to raise the debt ceiling. And in addition, we have inherited a financial crisis that makes it important for us to respond to that financial crisis.

But, you know, a year ago we were seeing 700-plus jobs a month lost, financial institutions essentially on collapse, and housing industry, in a collapse as well. So we believe that we have stabilized some of those really serious economic situations in this country. I appreciate the fact that you have also recognized it is going to take us a while to get ourselves out of this very, very deep recession and deep fiscal crisis. So I did want to just, and I was going to ask maybe, start with Mr. Podesta, if he would, really both reaffirm that, in fact, the deep decline in revenues, some of that from tax cuts under the Bush administration, they literally had a policy of reducing revenues through deep tax cuts and increasing spending at the same time. We heard about two spending pieces that were not even mentioned except for the part D, which was a good idea except unpaid for, and that was a huge problem to not anticipate what it would cost even though they seemed to know it, and also to, and of course, two wars, which is a huge—that was off budget.

But also some policies they know they were never going to use. The AMT was pointed out, Mr. Greenstein pointed out that we were not really going to apply the AMT to 30 or 40 million Americans, but still that made the budget look better than it was. And, you know, we need to, what we want to do is deal realistically and we have, even in this last year, done a really budget that reflects war costs and the reality of the future. So could you just briefly, both confirm that, in fact, my analysis of how we got here is correct, and then insights on how we, and I appreciate some of the very concrete ideas already. But first as a commitment to deal with this and secondly, understanding that it is going to take a while for us to get ourselves out of this mess that we inherited, but some strategies of the Clinton administration and to turn that around, in 8 years, turned around the economic situation in the country and the budget, and left this Bush administration with a surplus, which, of course, has now been turned into an enormous debt. So I don't think you have too much time but if you could answer that that would be much appreciated.

Mr. PODESTA. Well, I think that really underscored the point that it takes some courage, it takes some political will or takes compromise to move it this forward. But as my testimony notes, when President Clinton came into office the debt, I am sorry, the deficit was 4.6 percent of GDP. We obviously brought that down to a balanced budget and created a surplus which we passed off to President Bush. That included the restraint on programmatic expenditures in addition to a change in receipts particularly in 1993 when the President, with, by one vote in both the House and the Senate passed a budget plan that put us on the path towards that balanced budget which was completed in 1997. I would just note, what did that mean for the American people, not just what did it mean to the Federal balance sheets. 23 million jobs were created. Compare that to the 8 years of President Bush, 2 million jobs were created. GDP growth rate was higher. Median income went up, didn't stay flat. Wages kept growing for all parts of the wage spectrum. So it has direct effects on the well-being of the American public. And by the way, I think that the President also managed to cut taxes even in that original bill for people at the low end of the wage skill, which I would recommend, as was done at the beginning of this year, that the expansion of the earned income tax credit and the child tax credit be extended as you think about the needs going forward.

And what happened in 2001? We had two major tax cuts while we were engaged in two wars that were, as you noted, where sort of the real costs were hidden in the budget process. The defense budget has now more than doubled from where it was in 2001. I think particularly the decisions, again, this is policy decision, but sort of disguising the long term cost of the war in Iraq was both a strategic mistake for the country, and I think obviously we are paying a huge price going forward with that.

So that was just a dramatic turnaround, 10 points of GDP on the deficit side. And it has created a debt balloon. And I would just finish with one thing. As we look at these massive numbers that we have been talking about in terms of the deficits and payments on the debt, fully a quarter of them are attributed just to the debt accumulated during the last 8 years of the Bush administration.

Ms. SCHWARTZ. Thank you. I believe my time is up, but I think that is important history and does help us moving forward, and look forward to the material you are going to send us and tackling this. Thank you.

Chairman SPRATT. Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman. First of all, just one little anecdotal comment about commissions. In my home State of California where we have had a continuous budget crisis since 2002 the Republican governor and Democratic legislative leaders appointed a bipartisan commission that had business people and union leaders and think tank people and all that. They couldn't even agree amongst themselves on the commission with a unanimous suggestion on how to resolve the budget, and so there was a majority report and a minority report that came out of the commission which was summarily rejected by both Republicans and Democrats elected to the legislature.

So, the commission thing sounds good, but I generally think we need to do our jobs as a Congress, and that punting it there doesn't always solve the problem, at least in my home State of California it hasn't so far. The one question I would like to ask and discuss is, given the severity of the problem, which there is, I think, unanimity on that, given the difficulty of the solutions, which involve changing programs dramatically, reducing spending, raising revenues, whatever, isn't the one thing we ought to not be doing what we have been doing lately. If we have entitlements that we already can't pay for, shouldn't we not be adding new entitlements?

If we have all kinds of unfunded mandates and so forth on States that are having trouble, shouldn't we stop doing more unfunded mandates? If we are looking at problems with discretionary spending and things we have to reduce, shouldn't we stop creating new programs, now agencies, new commissions and new discretionary spending? Wouldn't the very first thing—and because clearly this won't solve the problem in and of itself. But shouldn't the very first thing we should do be to stop creating any new spending program or any new entitlement or any new thing?

Now, one more comment and then I will let the panel comment on this. But I know some of you have mentioned PAYGO. But let me suggest that amongst the problems with PAYGO might be, if, in order to solve this problem long term we have to raise taxes, cut spending or some combination thereof, then every time we add new spending and pay for it by cutting some existing spending, or raising some taxes, we use up some of the capacity to solve the long-term problem and I would argue, some of the fiscal capacity, but also some of the political capacity to solve the long term problem when those revenue increases or spending cuts could be used to solve the overall problem.

So rather than PAYGO, I would like to suggest we have, we put instead in place "spend stop" and that we just stop that as a start, so that then we can deal with the long-term problem; and open that to whoever would like to comment.

Mr. CAPRETTA. Well, first, I totally agree with your point of view so—I am not sure the other panelists will, but from my perspective, this conversation has a little bit of a surreal aspect to it because we are in the middle of a very long struggle over a health care bill that would vastly expand health care entitlements which is actually, Social Security is a big part of the problem, but the health care entitlements even I would admit are even a bigger part of the problem. And so we are going to add, which they have been growing, CBO has told us repeatedly, the health care entitlements have been growing at a rate of 2½ percentage points, a little bit less now, but more than two percentage points per year faster than GDP growth on a per capita basis since 1975, so that is a very long period of time.

And then the bills that are under consideration would add a new entitlement on top of it which essentially would grow at that same rate. They are not saying that this would, the bill would slow the pace of this new entitlement down to GDP growth. It would actually grow faster than the economy. And so I think you are exactly right, that, you know, all this concern about debts, mounting debts, mounting deficits are very much interrelated with the entitlement problem and the health care bill in particular would exacerbate that on very questionable assumptions about cost control later, which, as I outlined in my testimony, I am very dubious about.

Mr. CAMPBELL. Let me get some other comments. And it is not just health care. I mean, we are expanding all kinds of things every week in this place. Yes. Mr. Greenstein.

Mr. GREENSTEIN. I am obviously in sympathy and in sync with the goal of long-term deficit reduction. But I would have problems with the particular remedy as you mentioned it. For example, you said spending stop. You didn't include revenues in there. As Maya MacGuineas noted, we now have close to $1 trillion a year of tax expenditures which are effectively spending or subsidies that are delivered through the Tax Code. If you were to do a one-sided control, what you would do is greatly increase the incentives for lots of lobbies of spending.

Mr. CAMPBELL. Okay. So you do both.

Mr. GREENSTEIN. But more fundamentally, the problem I have with this approach is the economy is constantly changing, the world is constantly changing. There will be new needs. They will require at various points, various new things in spending or taxes. The right remedy, I think, is not to ignore changes in the world that have to be responded to and say you can't do anything new, but to say the new things that are done have to be in a larger context where we are setting priorities so we are able to do them and do long term deficit reduction at the same time. And with regard to PAYGO, I think PAYGO is an essential first step. It is a necessary but far from sufficient condition.

Mr. CAMPBELL. Okay. Ms. MacGuineas.

Ms. MACGUINEAS. Thank you for your question. I share your concerns. I think that it is not the moment to be adding new programs. And I also think it is not the moment to be extending or cutting taxes further. So I look at this from both sides. I think that and to wait on health care is a dangerous thing right now. And I will say out front my board of directors, I have all different perspectives of the people, how they feel about where we are on health care. Some would like to see this not go forward, some would very much like to see it go forward.

I think one of the arguments I was sympathetic too is that in health care reform you could really put a lot of cost saving mechanisms into a health care bill and you needed to include some form of a sweetener to allow those things to go forward. The problem is that the sweetener has grown, and the cost savings have shrunk. And the other problem, more broadly is that, we, over the past years, have given so many of the budgetary sweeteners away that we are really left with very few things left to help grease the wheels of some of these tough fiscal choices.

So we did prescription drugs without reforming Medicare. That was a very large mistake. It looks to me like we may well be about to extend a lot of expiring tax cuts without using that as the hammer to force the big budget deal. I think that would be unwise. So I would stop on both sides of the budget and not do those things until we focus on the fiscal issues. I would also say, about things not to do, I would ask that Members of Congress not promise not to do other things. I think anybody who puts forward a productive idea that would help close the fiscal gap we should say, thank you for that idea, rather than saying I promise not to do things. But I think the list of priorities has to be make sure the economy recovery sticks, make sure we quickly pivot and focus on fiscal consolidation issues, and then and only then can we really look at other priorities that any of us might have. I would like to see more spending on certain investments in the next generation. I would like to see corporate income tax cuts, but I would not like to see those kinds of things on either side of the budget until we have the fiscal situation done first.

Mr. PODESTA. I want to give you a kind of specific example of why I think the approach that you outline has flaws and has problems. It sort of assumes that what we are doing now is all good and anything we could think up is actually not more effective, more efficient, and actually will create greater productivity in government. And I will give you a specific example and relate it to your own State.

Ms. KAPTUR [presiding]. Excuse me, Mr. Podesta. We are going to have to ask you to summarize quickly. We would like to move on.

Mr. PODESTA. The Race to the Top Fund that was included in the Recovery Act that the Secretary of Education has implementing has caused massive changes across the States already, including in the State of California where the State was moribund in its ability to try to effectuate change in the way teachers are compensated in the State. Just that one input has caused the State of California which can't seem to do anything, to pass a law that really is, I think pushing the edge of reform in education.

So I think we want to weed out the bad things, enhance the good things, I think that is why PAYGO discretionary caps make sense because you can pick and choose between the best and the worst. And maybe at some point, I will come back on health care.

Ms. KAPTUR. Thank you so very much. Mr. Doggett of Texas.

Mr. DOGGETT. I think the predicament that each of our witnesses has described is hardly surprising. Much of us opposed with vigor the fiscally irresponsible policies of the Bush-Cheney administration, which squandered the surplus that they began with and converted it into trillions of dollars of debt, borrowing during those Bush-Cheney years, more money from foreigners than had been done by all presidents, all administrations in American history up to the time that they began their borrowing spree. Indeed, there were some groups and some Republican commentators here in Washington who actually advocated during the Bush-Cheney years that driving the debt up was a very good thing because it would assure that once Democrats were back in power, we would be limited in doing anything about health care, about education, or any of our other social responsibilities.

And I will have to say that, as irresponsible as that Republican strategy was, it has almost proven to be an effective way to restrain our answers, our attempt to answer the tremendous health care problem that we face today. I listened with interest to the questions to you from my Republican colleagues. It seems to me they are pursuing the same strategy they have in the past. When we look at a lake level down in Central Texas, we consider not only the water that is flowing out, but the water that is flowing in. They want to focus only on the expenditure side, which does need to have careful evaluation given the predicament that they have left us in, but they don't want to focus on the revenues flowing into the Treasury.

Indeed, to the extent they focus on it, they would continue the Bush tax cuts which helped get us into this situation. Indeed, almost $2.5 billion of the problem we face today is a direct result of the Bush tax cuts and another $1.5 trillion is the interest we will be paying on the tax cuts that we have already incurred to date. And if we follow the Republican directive, the ideologically driven goals of the Republicans are that Wall Street titans and bankers just haven't gotten enough tax breaks and that what we need to do is to invest from the Treasury another $5 trillion over the next few years, don't have that flowing into the Treasury, but use it to extend permanently the tax breaks to the wealthy few.

Let me ask you, Mr. Podesta, your feeling about extending all of the Bush tax breaks and denying the Treasury the revenues that they would produce.

Mr. PODESTA. Well, I think this would be a terrible mistake. You just dig the hole deeper if that is what would happen. One of the challenges you have right in this year is what to do about the estate tax which has now, as a result of the inability of the Senate to act, now gone to zero. But I think that going forward, I think what the President has proposed makes sense, at least in the short-term, which is to extend the middle class tax cuts and to extend the tax cuts that were included in the ARRA. As I said, I particularly point to the EITC and the child tax credits that were included there. But 95 percent of the American public had tax relief in that bill. But not to extend the high end tax cuts that were included in the 2001, 2003 bills.

Mr. DOGGETT. You and two of our other witnesses have referenced tax expenditures. And as you know, with no new taxes as the first commandment of politics here for the last decade or so, we have increasingly used tax expenditures, rather than direct expenditures. For example, and I plead guilty myself. I authored a $13 billion tax cut that was part of the Economic Recovery Act for Higher Education to help people go to college. Don't you believe that all of these tax expenditures need to have the same rigorous examination as to how effective they have been, whether it is higher education or research and development or any of the other expenditures for taxes that are outlined in the Senate budget documents that are part of the true budgets of the Federal Government.

Mr. PODESTA. I would completely agree with that. And I think Ms. MacGuineas would as well. And I think that we look forward to working with you on that. I think one of the other ideas that we have put forward in our proposal is if there is a sequestration mechanism built into a budget path going forward that tax expenditures along with spending be included in that.

Mr. DOGGETT. Mr. Greenstein, during the last several decades, the amount of revenues that corporate America contributes to our Treasury have gone steadily downhill with corporate tax loopholes, with various other gimmicks they use internationally. Don't we need to ask our corporations to pay a fair share of the cost of addressing the Federal problems, the fiscal problems that you have outlined today?

Mr. GREENSTEIN. We have a very interesting situation with a corporate tax. One often hears it said that the corporate tax rate in the United States is higher than in most other western countries, and that this puts us at a competitive disadvantage. Well, the marginal rate is high in the United States relative to most other countries, but the effective tax rate is not. What we basically have is a kind of the worst of both worlds. We have a plethora of special interest corporate tax expenditures that erode the tax base, and then we couple that with a higher rate than a number of other countries have.

President Obama, in his first budget proposed, I thought, a series of courageous and excellent policy measures to close some of the most egregious, unproductive and most special interest corporate tax loopholes, and so far, nothing's really happened on those up on Capitol Hill. Frankly, if we were able to broaden the base enough and to close enough of those unwarranted tax expenditures, you could actually use some of the money to lower the marginal corporate rate and some of the money for deficit reduction.

But I think the corporate tax area is definitely an area with a focus on the tax expenditures, that will need to be one of the contributors to a long term deficit reduction.

Ms. KAPTUR. The gentleman's time has expired. I would like to move on to Ms. Lummis of Wyoming, please.

Mrs. LUMMIS. Thank you, Madam Chairman. I know it is really fun to talk about what President Clinton did, working with a Republican Congress. But I would really like to focus more in the future with my questions. And my first is for Ms. MacGuineas. You cosigned a report called Red Ink Rising. And it states that the long-term budget problem is primarily a spending problem. If we, as policy makers, choose not to control spending, but, instead, focus on raising taxes to meet the spending requirements in the coming decades, what would be the effect on the economy?

Ms. MACGUINEAS. I don't think there would be any disagreement from anybody of any political persuasion that you cannot close the fiscal gap exclusively or even primarily on the revenue side because it would have too damaging an effect on economic growth. Now, people differ about where they think marginal tax rates become problematic. I am not worried about where they are today. But we are talking about, and I wouldn't mind seeing those rates go up somewhat. I think that is one of the things that should be in the tax mix.

But that is a small amount that I think we could afford before you start really taking a hit on productivity and economic efficiency if you start talking about closing this on the revenue side, you are going to slow growth. And there are two things that help you stabilize the debt, policy choices that bring down spending or increase revenues, but also economic growth, the denominators, the GDP. And I am always worried about excessive promises. You know, certainly cutting taxes isn't going to raise revenue and close the gap. But you want to tax smartly.

Likewise, I am starting to get very worried about people talking about spending that is going to promote economic growth. So if we just spend the right way that is going to grow the economy. You know, we can't have sort of false promises. We do want to focus on economic growth but there is no magic recipe there for growing the economy. But what we do know is that excessively high tax rates will slow growth. You want to be careful about bringing rates too high.

But you also want to be really careful about your tax bases, and that is why I think that we should be looking at broadening the base, reforming the bases in many places, and thinking about taxing more of things that you want less of such as pollution or consumption, not taxing more of things that you want more of. In the end, this gap is huge. You are not going to be able to close all of it by anyone thing. Everything is going to be in the pot.

Mrs. LUMMIS. Okay. Thank you. Another question. We have been issuing record amounts of debt, last year, about $2 trillion, this year could be about $2 trillion. The Federal Reserve has monetary policy at full throttle. And we have all acknowledged, you have all acknowledged that, you know, we are on a dangerous path. And before I start talking to you about the guide path that you have worked on, how would you rate the risk that we are beginning to reduce confidence globally in the debt that foreign countries are buying from us?

Ms. MACGUINEAS. It is a great question. We are actually going to hold a conference in a couple of months on what would a fiscal crisis look like because there is so little understanding of how it actually would play out in markets. And similarly to that, there is so little understanding about what point we will hit the tipping point. All we know is that you don't want to find out by reaching it.

But we can disagree on what level of debt you need to stabilize at or how much more we can afford to borrow. And anybody has to have enough humility to say we don't know which point we are going to hit that. One of the problems is that we are not the only country running large deficits and that there is an amount of global savings that is available. Obviously that can change depending on what rates you pay. But we are going to have to pay higher rates to attract more capital. I would say that the interest, the changes that you risk are twofold. I think it is more likely that we have a slow deterioration in the standard of living, sort of the lost decade problem. But there is still a significant risk that we have a spike that can lead to a vicious debt cycle because interest rates are growing faster than the economy as a whole. Nobody knows.

We have tried to model it with the best models out there can't predict, given this situation, at what point we will hit the level, and so we know we need to be reassuring all along the way. Get ahead of the crisis as quickly as we can. I wish I had a specific right number.

Mrs. LUMMIS. And another question for you. With regard to your report, Red Ink Rising, and the glide path down to 60 percent of GDP, how did you derive that number? I think that that is kind of what Europe's focused at. What happens if we suddenly and in a less robust number like 65 or 70, or try to push it to a more robust number, say 50 percent, 40 percent?

Ms. MACGUINEAS. And we and other folks who have recommended 60 percent have been clear that there is no one answer. 60 percent just because of momentum behind that number has become the international standard. And what we are focusing on is trying to come up with a plan that would reassure global credit markets. It seems like, given that all numbers arbitrary, you want to go with what the global standard is becoming. So 60 percent is a reasonable number. If somebody said we are going to stabilize the debt at 65 percent by 2018, we would be thrilled.

Frankly, I think that we are far less worried about us picking too aggressive a goal and doing too much on deficit and debt reduction than we are about not doing enough. So let's push this as far as we can as a starting point, understanding that it may well get watered down over time.

Ms. KAPTUR. Thank you very much. The gentlelady's time has expired. I would like to announce for the members that within the next few minutes we will be called for votes. There are likely to be five votes. I would suggest that we will continue the hearing. If some members want to leave after questioning and come back, and we will call on people in the order that they have come to the hearing. Thank you very much. Congressman Blumenauer.

Mr. BLUMENAUER. Thank you, Madam Chair. Actually, I find this hearing a little encouraging because I think we are fast approaching the same situation relative to the deficit and spending as we are, for instance, in health care. Something's going to happen with health care because the system is no longer sustainable. It is slowly getting out. Some of us think we have maybe reached that tipping point, but it is going to happen much quicker, I think, because of the problem, the magnitude of the problem, and the awareness that is developing. I think you have illustrated here a broad cross section of opinion where some things can happen. There is a glide path. I am of the opinion that when the politicians stop talking about how bad the problem is and how we got here, we can do a little of that, and really start sitting down and talking about what the solutions are going to be, it is not going to look that much different than what happened in 1983 when we got down to cases and we were able to solve it. It is not beyond our capacity and things like Social Security are out there long enough in the future that you can slowly bend that curve and be able to make a very significant difference. And the health care piece and Medicare, I think is likely to happen sooner rather than later for forces beyond our control.

And when you mentioned agriculture, I mean, I am thinking our distinguished ranking member, Mr. Ryan, and I have been part of a bipartisan effort that could make a big difference in terms of deficit reduction and actually be fairer to most farmers and ranchers, and we are going to get there in part because of deficit pressure, in part because the public is becoming aware of how concentrated those benefits are and how they are shortchanging people. And there were opportunities. We actually had, the administration absolutely made a misstep in terms of how they calculated a proposal, but there was daylight there. One thing you haven't talked about is another deficit that is financial and that is our infrastructure deficit. We have a highway trust fund that is in deficit for the first time in history, and we are having to shore it up with general fund revenues, adding to the deficit. And I wonder if you could, perhaps, talk for a moment about the role that user fees might be employed to help shore up the Federal balance sheet. At the same witness stand that you appear, we have had representatives from the U.S. Chamber, truckers, the Triple A, small business, contractors come in and say, raise the gas tax. The administration has, in its last budget, and I think maybe in this next budget reinstatement of the Superfund tax which was a logical user fee that was used to clean up this toxic waste in every State in the union. And there appears to be significant support, actually, pollster Frank Luntz, a Republican pollster, found across-the-board support, Republicans, Democrats, and independents for a modest increase in fees to deal with infrastructure like water and transportation.

It appears to me that this speaks to ability to pay, to direct benefit and economic redevelopment. Any thoughts that any of you have about the potential of going back and looking at user fees to help shore up this in a non ideological and possibly even bipartisan support? Remember, Ronald Reagan, in the midst of the recession in 1982, supported a 5 cent gasoline tax increase.

Mr. PODESTA. Well, I think there is, that is a very—first of all, I hope you are right, Mr. Blumenauer. I kind of share your enthusiasm for finding the capacity to come together on some of these issues. And I think that it is clear that our infrastructure's in terrible shape in some places and needs vast improvement. And there is a wealth of user fees to support that. But the most important perspective on that is that it enhances productivity and enhances new job creation, innovation, et cetera. I think there is a role for the physical infrastructure which you have concentrated a good deal of attention on. I would also point to the energy infrastructure of this country, and to deal with the energy security problem we have through, imports of oil versus the capacity I think to tap vast reserves of natural gas in this country and move to more clean productive energy.

And one way maybe this is not usually thought of as a user fee. One way to, I think, finance that is through a, we call so-called green bank or the energy deployment administration, to use fees from the provision of credit in that infrastructure to create capacity and I think that would enhance innovation productivity.

Ms. KAPTUR. The gentleman's time has expired.

Mr. BLUMENAUER. I am very interested in the other members. Maybe we could follow up either in writing or I could visit with the other members of the panel to get their opinions.

Ms. KAPTUR. I thank the gentleman for his courtesy. And we will turn to Mr. Garrett of New Jersey.

Mr. GARRETT. Thank you. And before I begin, can you bring up the chart that was up before? I guess it was the majority's chart with regard to the history. There we go. So before I get into my comments maybe I will throw this out to Mr. Podesta, for example. Because when I look at this chart, I don't have my long glasses on here with me. But no one could look any of that blue up there which really should be red, I guess. But what strikes me from my angle where I am sitting right here is that spike at the end. So remind me, who was in control of the House and the Senate? Who was in control of Congress during that period of time when I am seeing that spike on that chart over there?

Mr. PODESTA. Well, you know, I think that——

Mr. GARRETT. The Republicans or Democrats?

Mr. PODESTA. Mr. Garrett, I think that the Democrats took control in 2006 because the American people were quite frustrated and unhappy. And I think they are still frustrated and unhappy as was indicated in Massachusetts just this last week. But I think if you look at that big spike in debt, it is a combination of the matters that I mentioned. The wars, the tax cuts and then the meltdown that was the result of an economy that just went haywire.

Mr. GARRETT. Thank you. And you are using my time. But I appreciate your answer.

Mr. PODESTA. I apologize.

Mr. GARRETT. That is fine. I just bring up to set the record straight because the other side always wants to go back and I want to work in a bipartisan manner to say we really should be going forward. But to set the record straight, thank you. It was under a Democrat Congress. And if the Democrat Congress is not able to rein it in, then maybe things will change in 2010. But let me change the direction here. I serve on Financial Services. We spend a lot of time on the bond market and what is going on there. It was in December of this past year that Moody said that debt from the U.S. and UK has been now set apart from other triple A rated countries.

It is now classified in a weaker category than before. It is now called resilient and not resistant. The report said that in the worst case scenario, the U.S. could lose its Triple A rating in 2013 if growth slows, interest rates decline, and perhaps most relevant to today's hearings, if the government fails to address these problems that we are discussing today. Their chief international economist said the question of potential downgrade of the U.S. is not inconceivable.

So if you could bring up my chart now, this is from the Peter G. Peterson foundation, just very briefly, this looks at what we have been talking about here for the last 7 years with regard to entitlement spending which the ranking member has been talking about, I won't say ad nauseam, but for a lot. It shows you what? It shows you that all those entitlements, everything that all of you have been making the point on are just going through the roof, but revenue has been remaining essentially flat during this period of time. It goes up and down, what have you, which brings us to the problem. So let me just throw this question out to Mr. Greenstein. You made the comment, and I thought it was interesting, to say that we have to come up with a plan. Everyone here sort of says that. You made the comment when I first came in here saying that we really can't do it right now because of the economic morass that we are in right now. But we have to wait until we get out of it.

If we wait until we get out of it before we make some of these fundamental changes, very briefly because my time is almost up, can you say won't that potentially have a devastating impact just like Moody's and others are saying, on our bond rating and maybe not ever be able to pull out of it if our bond rating goes down and our interest rates go up.

Mr. GREEN. Let me clarify. I would favor taking action now. I would favor, however, that that action not actually be implemented until the economy recovers. You could pass legislation now that makes changes in taxes and spending that starts to take effect, say, in 20——

Mr. GARRETT. I appreciate that. But you also, and Ms. MacGuineas was also very honest about your assessment of how Congress responds is that we don't take the actions today. We push off in any of our budgets later on, so even if we had those actions in writing now, both of you sort of made the same comment, that when those things, when push comes to shove a couple of years down the road, when doc fix eventually has to go into effect, the political pressure would be at that point, 5 years down the road, repeal that.

Mr. GREENSTEIN. No, I disagree with that. We actually did a major study about a month or 2 ago of every savings measure enacted under Republican and Democratic Congresses and Presidents in the Medicare program from 1990 forward. This is encouraging. Of the changes made under the bipartisan agreement in 1990 under the first President Bush, 100 percent of the Medicare savings provisions stuck and became law. Of the Medicare savings provisions enacted in 1993, 100 percent stuck. Of those enacted in 1997, 77 percent stuck. Now, the main thing that didn't was the sustainable growth rate with the Medicare physicians. But it should be noted that when that was enacted in 1997, it was expected to have only very small effect. It was badly designed and it didn't work.

And by the way, under the Republican Congress, you made some Medicare and Medicaid savings in the Deficit Reduction Act of 2005 and those stuck. So I think the record shows you can enact—if you can enact them they can stick if they are well designed.

Mr. GARRETT. Thank you.

Ms. KAPTUR. The gentleman's time has expired. Congressman Edwards of Texas.

Mr. EDWARDS. Thank you, Madam Chair. I would like to begin by just making three personal points. First, I am glad we are having this hearing. I commend Chairman Spratt because I think deficits threaten our economic feature, our children and grandchildren's future, and even the political independence of our country as we become more and more indebted to foreign nations.

Secondly, I believe the ultimate solutions have to be on a bipartisan basis because, frankly, I don't think either political party, despite all the rhetoric, has the political will or even the political capability of making all the tough decisions alone, just as the 1983 fix for Social Security required bipartisan effort and I want to be one of those that will work and look for a genuine bipartisan effort. I would like to hear from my Republican colleagues, if you don't support any tax increases, where would you cut the budget? What are your ideas? And maybe we can find there is more common ground than we have done in the past and we have all spoken past each other.

Thirdly, I agree with Ms. Lummis that we ought to focus more on the future than in the past. I would add a foot note to that. I don't think we can ignore the past or we could be doomed to repeating the mistakes of past. And let me just say up front, both parties have been guilty. But for those who started out this hearing pointing the finger primarily at Democrats, let me just say for the record, that when President Bush 41 left office we had the largest deficit in the history of the country to that point, $292 billion.

When President Clinton left office 8 years later we had the largest surplus in American history. And when President Bush 43 left office, 8 years after that, we once again had the largest deficit in American history, by a magnitude of four times the previous larger debt of any other administration in his father's administration.

Having said that, frankly, there is enough blame to go around. And let's not ignore the past. But let's figure out a way to move forward and look for some common ground. On the issue of not wanting to repeat the mistakes of the past, I would like to see if any of the panelists could add any specificity to how much the deficit would be increased with the passage of some of the additional tax cuts that have been discussed in Congress. Specifically, do any of you know how much the deficit would be increased over a 10-year period if we made all the Bush tax cuts of 2001 and 2003 that are temporary, if we made all of those permanent? Any ballpark number? It doesn't have to be exact, but any idea?

Mr. GREENSTEIN. It is several trillion. I don't remember the specifics number. It is several trillion dollars over 10 years.

Mr. EDWARDS. Several trillion dollars if we made all of those temporary tax cuts permanent. What if we had the complete repeal of the estate tax? I think we had a debate on that recently. Democrats supported continuing the present level of estate tax exemption of I think 1½ million for an individual, three million for a couple. I may be mistaken. I think my Republican colleagues supported complete repeal of the estate tax.

How much would the complete repeal of the estate tax cost over a 10-year period.

Mr. GREENSTEIN. Over a 10-year period from, like, 2012, which is the first year you get the full effect, through 2021, including added interest payments on the debt, it is close to $1 trillion.

Mr. EDWARDS. So that would increase the deficit by $1 trillion.

Mr. GREENSTEIN. I think it is a little under $1 trillion, but it is close to $1 trillion, if I remember.

Mr. EDWARDS. Okay. Some have proposed cutting the corporate income tax rate by 5 percent. Do any of you have any numbers, any X percent cut in the corporate tax rate would increase the deficit by Y billion dollars?

Mr. GREENSTEIN. I don't have the figure in my head. We can get that for you.

Mr. EDWARDS. Oh, okay. How about, the proposal has been made to eliminate capital gains. And I voted for capital gains tax reductions as a way to encourage investments. But given the massive deficits we are facing, any idea how much eliminating the capital gains tax would add to the Federal deficit?

Mr. GREENSTEIN. I don't know the figure. It would be massive. And the reason it be would massive is, if you had no capital gains tax at all, you would have an absolute explosion of tax sheltering. You would have an extraordinary incentive for people to convert ordinary income into capital gains.

Mr. EDWARDS. And, Mr. Greenstein, I have tremendous respect for your leadership and the work you have done over the years. I wish we had followed your advice more than we have at times.

I would just take issue on one point. And I might have misunderstood you, but I think you said we have to be careful not to do too much on the deficit in the short run. And I understand the problem we are facing with a slow economy. I do think we have to earn back the trust of the American people. So I think it is essential this year in our discretionary budget that we not just talk about processes and processes and entitlement spending. I think we need to make some tough decisions on discretionary spending in order to begin that process of earning back their trust. Until we earn back the American people's trust so we can get control of the deficit, we won't be able to solve the problem.

Mr. GREENSTEIN. I don't disagree with that. And, again, as I clarified with Mr. Garrett, my comment is: Things that would really have big impacts on aggregate demand you don't want to put into effect when you have a 10 percent unemployment rate. I actually think it would be useful to begin to enact some of those things this year, if one could politically, but to have them take effect after several years.

At the discretionary level, on the issues we are, kind of, talking about, perhaps one of the best things could be if we could do some things we need to do and, as John Podesta suggested earlier, find the money to pay for them by shaving the lower-priority things within the discretionary budget.

Ms. KAPTUR. I thank the gentleman. His time has expired.

And we have a series of votes on now. This one will be 15 minutes. We have time, I think, for both Mr. Boyd's and Mr. Connolly's questioning. And that is respectful of our witnesses, as well.

Congressman Boyd?

Mr. BOYD. Thank you, Madam Chair.

I thank all of you for coming.

Mr. Capretta, I have had the opportunity to sit with the other three witnesses on occasions, and I understand a lot about where they are philosophically about how to deal with some of these issues. And you have quite an impressive resume. I was quite intrigued, after reading that resume, that you spent your time and testimony tearing apart two health-care bills that many of us think will have a funeral soon anyway. And I want to delve a little bit more into some positive contributions that you may make, given the fact that you spent several years in the White House in the OMB office.

And can you tell me, relative to all of these issues that have been laid out, budget issues that we are facing today—Medicare, SGR, AMT, estate tax, Tax Code issues, all of those issues, budget deficits—specific things that you could suggest that you all developed, advocated for, and implemented during the time that you were in the White House? So maybe we can take some of that as a lesson and advance it here.

And let's start with the SGR.

Mr. CAPRETTA. With regard to the SGR, it was done on a year-by-year basis, actually, during the Bush administration.

Mr. BOYD. So there was never any attempt to develop a long-term fix in the SGR when you were in the White House?

Mr. CAPRETTA. At that time, I am not sure, actually, if we did develop one. I am not positive. I haven't thought about that in quite a while.

Mr. BOYD. Okay. I think I am pretty sure. Probably didn't.

What about the alternative minimum tax? I mean, that is a policy baseline issue that we know that this Congress and the American people would not stand for sunsetting.

Mr. CAPRETTA. Actually, I do recall that the Bush administration—I wasn't involved in it, but the Bush administration did propose trying to deal with the AMT through a broader tax reform initiative they tried to get going. There wasn't a lot of bipartisan interest in doing it, but there was a proposal.

Mr. BOYD. But it was not part of the 2001 or 2003 tax program.

Mr. CAPRETTA. No, a permanent fix on that was not in those bills, that is correct. But the President did propose to try to deal with a permanent fix in the larger tax reform initiative that, quite frankly, didn't get a lot of traction. But that was where they——

Mr. BOYD. Right. But the one that did get traction, it was not in?

Mr. CAPRETTA. It was not in the 2003.

Mr. BOYD. Okay. What about the estate tax? Now, we know—well, maybe everybody here doesn't know what a mess the estate tax is. But an estate tax which graduated the exemption from 2002 until now. Now the estate tax is gone, and then it comes back at the end of this year at the 2000 levels.

What about the estate tax? Was there any advocacy?

Mr. CAPRETTA. I am not familiar enough with the estate tax to answer your question. I am sorry.

Mr. BOYD. Okay. What about other parts of the Tax Code? So have you got anything that you can point to that we can take out of this hearing that will be productive and not tearing down something that somebody else has proposed, but would be productive for us to advance so that we can fix this long-term fiscal crisis that we are entering that many of us have been saying for years was coming?

Mr. CAPRETTA. That is a good question. I have two things to offer.

First of all, you might recall that, after President Bush was reelected in 2004, he did try and spent a lot of his personal time trying to get a Social Security reform program enacted. And he tried to do it on a bipartisan basis.

In fact, he endorsed and proposed the largest change on the spending side of Social Security a President has ever proposed by putting progressive indexing actually on the table. It would have solved entirely the Social Security problem in one piece of legislation. We would be in a lot better shape today if Congress had taken up a bipartisan Social Security plan in 2005.

In addition——

Mr. BOYD. That was a year that—back to what Mr. Garrett said——

Mr. CAPRETTA. I have one more thing.

Mr. BOYD. Who controlled the House and the Senate in early 2005?

Mr. CAPRETTA. It was Republicans. I don't think——

Mr. BOYD. I wanted to make sure that I understood who you were blaming here.

Mr. CAPRETTA. It is very clear, though, that a Social Security reform program is going to need bipartisan support. And the leadership of the minority party at that time made it very clear they were not interested in doing a Social Security plan. So, I mean, I am not trying to be the one who blames, but if you go back and look at the record, President Bush did put on the table a long-term plan to fix Social Security, the Congress did not take it up, and that was largely due because there was not bipartisan support for it.

On the Medicare program, you asked me about the Medicare program, at the time the Medicare drug benefit was enacted, there was a major effort to try to build into that—and President Bush personally pushed for it—larger reforms in the underlying Medicare program. Again, to get some bipartisan support for that drug benefit, actually it was the minority party that insisted those larger reforms be left out of the package.

Mr. BOYD. And my time is up, Mr. Capretta, and I appreciate your being here and your testimony. But I also would remind the Members that, when that reform was done, the Republicans controlled the White House and the Senate and the Congress—and the U.S. House.

And I yield back.

Ms. KAPTUR. I thank the gentleman for respecting the time limit in the interest of our colleagues.

Congressman Scott of Virginia?

Mr. SCOTT. Thank you, Madam Chairman.

Let me just ask a couple of questions.

Mr. Podesta, on chart number two, the policy that created the blue during the Clinton administration, did you have a commission to enable you to do that?

Mr. PODESTA. No.

Mr. SCOTT. If a commission got the budget straight one year, what would happen the next year—if you need a commission to get you straight to begin with——

Mr. PODESTA. Well, I think what we had, Mr. Scott, to your point, is we had statutory PAYGO, we had budget caps, we had budget discipline. The Congress was able to, in that context, first time only the Democratic votes and on a bipartisan basis, fix the problem. But it took leadership, and it took, you know, political courage.

Mr. SCOTT. But the point is, if you fixed it once, you would need an ongoing commission——

Mr. PODESTA. I suppose.

Mr. SCOTT [continuing]. If you didn't have the leadership.

The second is chart number four. How many jobs a month do you need just to keep up with the population?

Mr. PODESTA. I think about 175,000.

Mr. SCOTT. And you were able to create jobs and maintain fiscal responsibility during the Clinton administration?

Mr. PODESTA. Yes. As I noted earlier, 23 million jobs were created in the United States during those 8 years.

Mr. SCOTT. Was that an accident or because of policy?

Mr. PODESTA. I think it was the result of policy that invested in people and technology and good stewardship with respect to freeing up credit by controlling the deficits that the government was running.

Mr. SCOTT. And you were able to do that while maintaining fiscal responsibility?

Mr. PODESTA. Absolutely.

Mr. SCOTT. You would have paid off the national debt held by the public, what, by 2 years ago?

Mr. PODESTA. Yes.

Mr. SCOTT. Thank you.

I yield.

Ms. KAPTUR. I thank you very much, Congressman Scott.

And we just have a couple minutes left. I wasn't able to be here for your testimony directly. I have read it. And we thank you so very much on behalf of the membership.

As a member of the Defense Subcommittee of Appropriations, we had testimony yesterday that I will just reference to you as you do your own research because I found it quite interesting. In the Defense Appropriations Authorization Act of 2008, there was a requirement that DOD report back to the Congress on insourcing and outsourcing of contracted services. And because defense is such a large share of annual spending, the only department that has thus far reported back is the Army.

And if we compare a Federal civilian employee in Army to a contracted employee, their estimates show—this is GAO now—that the contracted employee costs an additional $44,000 to the Government of the United States. They did not report back on the military side, only the Federal civilian side at DOD. Navy and Air Force have not reported back. And I asked for the information, which they did not have; they don't believe anyone has it.

But we have to do something about defense spending. If I look at my career here in the Congress going back to the 1980s, it was the defense buildup, unpaid for, that then yielded us what we had to deal with in 1993, when Mr. Podesta and others took leadership and we were able to balance the budget by the end of the decade of the 1990s.

Now we are in the same position, conducting two wars, not paying for them. And the difference between insourcing and outsourcing is incredible. We don't have, from what we were told yesterday, the budgetary information so that we can make good decisions as Members. I just place that on the table for you because it affects everything as we try to dig ourselves out of this terrible debt situation that we do face.

So I just wanted to place that on the table. I have no questions of you at this point. We thank you so very much for making a very constructive contribution as we begin our year here of 2010. And I thank Congressman Scott for remaining until we adjourn the hearing.

Thank you.

I ask unanimous consent that Members who did not have the opportunity to ask questions of the witnesses be given 7 days to submit questions for the record.

[The information follows:]

QUESTION FOR THE RECORD SUBMITTED TO MR. CAPRETTA BY MR. ADERHOLT

1. You have suggested that political pressure would force Congress to increase entitlement spending and expand subsidies for health care. Political pressure in Massachusetts led to a very clear and blunt rejection of the health care takeover in the bills under consideration. Wouldn't it be better to try some separate reform bills and see how the government and the market can work together, and then use that knowledge for further reform in the future? Do you believe entitlement reform may need to be passed before health care reform?

ANSWER

You are right. From the Massachusetts election and polling data, it is very clear that most Americans do not want any version of the bills currently under consideration in Congress to pass.

What I meant in my testimony is that, if a version were to pass, it would create serious inequities that would be costly to fix later. Some low wage workers would get very generous insurance subsidies, while others would not. The difference would be worth several thousand dollars in many instances. Those getting less help would rightly complain of their unfair treatment, and Congress typically responds in such circumstances by extending the more generous entitlement to more people.

I agree entirely that it would be far better for Congress to pass commonsense reforms and then see how they work before proceeding with the kinds of sweeping measures now under consideration. One way to do that would be to allow the states to use their Medicaid funding much more flexibly to experiment with different reform approaches.

Also, as the testimony provided during the hearing demonstrated, the federal government cannot afford the health care entitlement programs already on the books, much less another one with rapid cost growth. I believe the problem of rapidly rising costs system-wide is driven in large part by the design of the government's existing programs. In particular, Medicare's structure encourages high volume and fragmentation in the way services are delivered. That drives up costs for everyone. What's needed first is a reform program that brings more financial discipline to the existing health entitlement programs, especially by giving the beneficiaries more control over the dollars. That will translate into a more efficient way of doing business, and make it more affordable to provide subsidized coverage to others.

QUESTION FOR THE RECORD SUBMITTED TO MR. GREENSTEIN BY MR. ADERHOLT

The Center for Budget and Policy Priorities (CBPP) states there is no "general entitlement crisis." The Social Security board of trustees expects the system to begin running a deficit in 2016 and public opinion polls show that fewer than 50 percent of respondents believe Social Security can meet its long term commitments. How is this not a crisis? Would you not suggest some reform to entitlements?

ANSWER

I'm afraid there is a misunderstanding here of what my testimony said. I believe my testimony said that all of the growth in federal spending projected as a share of GDP in coming decades is due to Medicare, Medicaid, and to a smaller degree, Social Security. I noted that all entitlements other than these three will, as a group, grow more slowly than GDP and thus do not add to the long-term fiscal problem. This, I said, is why there is not a "general" entitlement crisis—the issue is the projected growth in Medicare, Medicaid, and Social Security (which I call the "big three" entitlements) and an inadequate revenue basis, not all of the entitlement programs in the budget. I certainly believe, and my testimony indicates, that reforms in health care and Social Security will be necessary and should be made, along with tax reform.

QUESTION FOR THE RECORD SUBMITTED TO MS. MACGUINEAS BY MR. ADERHOLT

The Committee for a Responsible Federal Budget suggests a "debt trigger" that sets off automatic tax increases and spending reductions if benchmarks are not met. The Committee also suggests that the trigger apply equally to spending and revenue. During the hearing, you suggested that some cuts in defense spending would be necessary. Can you please go into greater detail regarding which programs will receive less funding? If certain benchmarks are not met, will the funding of our troops and national defense will be reduced?

ANSWER

Thank you for the question. The trigger would work as follows. Annual debt targets would be established as part of a debt stabilization plan in order to ensure that a plan stayed on track. Simply pledging to meet certain targets would likely not be sufficient to reassure financial markets-there have been too many past examples of insincere budgetary promises.

If a target were missed, the trigger would be pulled and any breach of the target would be offset through automatic spending reductions and tax increases. We recommend that the trigger apply equally to spending and revenue. There would be a broad-based surtax, and all programs, projects, and activities would be subject to this trigger. Past automatic policy changes failed in part because so many programs were exempt from the trigger and it was so easy to bypass the restrictions.

A debt trigger should be punitive enough to cause lawmakers to act but realistic enough that it can be enacted as a last resort if policymakers fail to act or select policies fall short of the goal. Using the broadest base possible would prove far more effective in keeping a plan on track since a broader base expands the political consequences of policymakers failing to meet targets, creating an incentive for Congress and the White House to craft their own fiscal policies, rather than relying on a formula to meet their debt targets. Certainly it would be possible, and desirable, to design the trigger to exempt "emergency spending" which would include all war spending, though not other areas of defense.

QUESTIONS FOR THE RECORD SUBMITTED TO MR. PODESTA BY MR. ADERHOLT

February 19, 2010.

Representative ROBERT ADERHOLT,
House Budget Committee, U.S. House of Representatives, Washington, DC.

DEAR REP. ADERHOLT: Thank you for the opportunity to share my views on the country's long-term fiscal outlook in front of the House Budget Committee last month. Attached are answers to your questions that were submitted for the record.

Once the economy has fully recovered, putting the nation on a more sustainable fiscal path will be critical for achieving stable economic growth. As I mentioned in my testimony, it is the responsibility of today's policymakers to develop a credible path forward.

The scale of the challenge demands an intellectually honest approach that starts with a sober assessment of why the fiscal outlook has deteriorated since the budget surpluses achieved during President Clinton's second term. After the 2000 elections, the Bush Administration inherited a $236 billion surplus, the largest since 1948. By the time President Obama was inaugurated, the deficit had reached $1.2 trillion, a swing of 10 percentage points of GDP over just eight years.

This dramatic deterioration of the federal budget was due to the decision to cut taxes, which cost $2.5 trillion over ten years, while spending over a trillion dollars on the wars in Iraq and Afghanistan in addition to $800 billion on the new Part D prescription drug plan. When the recession hit, it caused a further decrease in tax revenues and required emergency spending, worsening current year deficits. Virtually all of President Obama's spending to date is due to the $787 billion American Recovery and Reinvestment Act.

The causes of the long term deficit, however, are threefold: the projected rise in federal health care spending, which will surpass private spending by 2012; the macroeconomic and budgetary effects of an aging population; and a chronic shortfall in revenues. For policymakers serious about reigning in long term deficits, health care reform is a necessary first step towards achieving long term fiscal sustainability.

Beyond health care, deficit reduction will require hard decisions on both the spending and revenue sides of the balance sheet. A process for making these decisions, along with annual deficit reduction targets, will be necessary to address the challenge at hand. I applaud the President's decision to create a bipartisan commission to develop a path to bring the federal budget into primary balance by 2015, a goal similar to that laid out in the Center's Path to Balance report.

Again, I appreciate the opportunity to appear before the Committee and correspond with you on this important issue. Please contact me if I can be of additional assistance. Thank you.

Sincerely,

JOHN D. PODESTA.

QUESTION

1. Your organization, the Center for American Progress, recently published "A Path to Balance: A Strategy for Realigning the Federal Budget." This report stated that 52 percent of the current deficit can be attributed to past polices of President Bush, twenty percent to the economic downturn, 12 percent to other reasons, and only 16 percent to President Obama's policies.

Perhaps in the interest of fairness, you can explain how you came up with these percentages, and also I would like to ask you for an adjusted figure. Which is, if one subtracts the funding spent on homeland security and the department of defense, how much of the remaining deficit would be attributable to the period of President Obama's Administration?

ANSWER

Our estimate that approximately 16% of the current deficit can be attributed to President Obama's policies comes from an earlier analysis appended to this document, "Who's to Blame for the Deficit Numbers?"

That analysis was based on a careful review of the thrice-yearly Congressional Budget Office reports on the economic and budget outlook for the United States. In each of those reports, the CBO details how and why its projections have changed since its previous release. By studying each of these reports, beginning in January

2001 when CBO was projecting a massive surplus for fiscal year 2009, we were able to track the change in the federal bottom line and ascribe those changes to various factors: specific legislative policies, changing economic conditions, and technical modifications. This produced a clear picture of the causes of 2009's historically large deficit.

Specifically, legislative changes undertaken under President Bush were responsible for about 40% of the fiscal deterioration. The financial rescue legislation, the so-called TARP law, that President Bush signed was responsible for 12% of the deterioration and another 20% can be attributed to higher spending and lower revenues that resulted from the onset of the Great Recession. Policies passed under President Obama are the cause of only 16%.

The Center for American Progress was not the only institution to carry out an analysis of this kind. David Leonhardt of the New York Times conducted a similar analysis and came to similar conclusions. He attributed 53% of the 2009 deficit to policies begun under President Bush. A report by the Economic Policy Institute found that only 8% of the deficit in 2009 could be attributed to the American Recovery and Reinvestment Act, while more than 40% was due to President Bush's policies. The Center on Budget and Policy Priorities estimated, in a paper released in December 2009, that more than 55% of the deficit was caused by policies begun under President Bush. Finally, it is worthwhile to remember that the Congressional Budget Office was projecting a 2009 deficit of $1.2 trillion before President Obama even took office, indicating once again that most of the fiscal damage had already been done.

QUESTION

2. For many years the discretionary budget has been in the $900 billion to $1 trillion range. The budget request for FY10 was approximately 3.5 trillion dollars, which was on top of a stimulus bill of almost one trillion dollars. Many departments received double digit increases. Won't this kind of domestic spending create an extravagantly large deficit?

ANSWER

President Obama's fiscal year 2010 budget requested $1.26 trillion in discretionary budget resources. Of this total, $663 billion was for the Department of Defense, and $52 billion was for the Department of State and other international programs. The remaining $545 billion that was requested in domestic discretionary spending was equivalent to about 3.7% of GDP. As a comparison, under President Bush, the federal government spent an average of about 3.5% of GDP on this category. More than half of the increase over President Bush's levels is attributable to increased spending necessitated by the 2010 census, as well as a larger request for the Department of Veteran's affairs.

The budgetary impact of this small increase in domestic discretionary spending was almost negligible. In fiscal year 2010, the federal budget deficit is projected to be about $1.5 trillion. Had President Obama requested no increase in domestic discretionary spending from 2009 levels, it would have reduced the deficit by less than 2.5%, and would have reduced overall spending by less than 1%. Furthermore, in President Obama's latest budget, he requested a level of domestic discretionary spending that would amount to 3.3% of GDP, below that which was spent under President Bush.

It should also be noted the American Recovery and Reinvestment Act was not "almost one trillion dollars." The total cost of the Recovery Act was estimated at $787 billion over ten years. Claiming that the bill costs $1 trillion inflates the real cost by more than 25%. Moreover, tax cuts and tax reductions accounted for about $280 billion of the cost of the Recovery Act. All together, ARRA increased domestic discretionary spending by about $260 billion, not the $1 trillion implied by the question.

Finally, the Recovery Act and small increases in domestic discretionary spending are simply not the causes of our long-term deficit challenge. Within five years, all discretionary spending will be at a lower level, as a share of GDP, than it was at any point in the last ten years. The deficits we face going forward are driven by increasing health care costs, an aging of our population, and a persistent lack of revenues to pay for the services and benefits that the American public demands.

QUESTION

3. Would you be in favor of reforming Fannie Mae and Freddie Mac, and perhaps other federal legislation, to ensure that lenders are not pressured to make home loans to sub-prime borrowers and to prevent another melt down in the home mortgage industry?

ANSWER

For well over a year, CAP has been leading and convening a group of experts that we call the Mortgage Finance Working Group to consider reforms to the mortgage finance system in this country. Minimizing systemic risk is a central premise of what a restructured secondary mortgage market will require, and to achieve that goal, among others, reform must address all players in the housing finance system. This includes tight regulation of all issuers of mortgage backed securities, for the bulk of subprime mortgages were securitized directly through Wall Street institutions that were never subject to risk oversight. Indeed, it was pressure applied to thinly capitalized mortgage brokers by Wall Street for mortgages with certain yields that could be packaged for sale as MBS immediately after origination that was the source of so many of the bad loans we have seen fail. By bypassing depository institutions with Community Reinvestment Act obligations and regulations, minority borrowers and those in underserved communities often got higher priced loans (ie, subprime) than they might have otherwise qualified for.

Just as we favor reforms of Fannie and Freddie, either in their current form or their successor entities, to more tightly regulated risk management, we must ensure a level playing field so that bad money does not drive out good. This is not to absolve the GSEs of mistakes: The GSEs badly failed in balancing long term safety and soundness against short term market share and profitability objectives. In this way, they contributed to the crisis.

The affordability goals mandated by Congress do not appear to have had a significant impact on GSE activity. Federal Reserve economists have estimated that the Underserved Area Goals contributed only an incremental 3.4 percent in lending activity, or 23 originations per Census Tract, in eligible neighborhoods from 1997 to 2002. Even as the goals were ratcheted up, they appear to have only a limited effect on Fannie Mae and Freddie Mac purchases and total credit flow. Moreover, Comptroller of the Currency John Duggan has stated unequivocally, “CRA is not the culprit behind the subprime mortgage lending abuses, or the broader credit quality issues in the marketplace. Indeed, the lenders most prominently associated with subprime mortgage lending abuses and high rates of foreclosure are lenders not subject to CRA.”

Rather, the growth in subprime, Alt-A, and exotic mortgages coincides with a dramatic growth in unregulated private label securities. Up until 2004, private label security issuance was a stable 20 percent of the overall market. That share skyrocketed to over half the market in 2005 and 2006, even overtaking MBS issuance by Fannie and Freddie. Similarly private asset-backed security (ABS) issuers, finance companies, and REITs accounted for 55% of the increase in home mortgage debt holding between 2003 and 2006, compared to 14% for the GSEs and agency-backed mortgage pools.

The shift is also evident in the share of mortgage originations. The years in which the worst performing loans were originated—2005 and 2006—were the years when the GSE’s share of originations was at its lowest in the past two decades. With FHA at a mere 2%, the government-related market was still less than 30% in 2006.

Thus, while one of the central goals of reform must be to minimize systemic risk, focusing solely on the GSEs would leave the door open to many bad actors engaging in the same types of behavior that lies at the heart of the housing crisis.

Who’s to Blame for the Deficit Numbers?

By MICHAEL ETTLINGER, MICHAEL LINDEN,* *August 25, 2009*

The revised deficit numbers reported by the Congressional Budget Office and the Office of Management and Budget today show a lower deficit than previously estimated for 2009, with higher deficits for 2010 and beyond. Political opportunists will be busy looking for chances to score points over these numbers—pinning the dismal fiscal picture on the Obama administration.

The real story is, however, fairly obvious. The policies of the Bush administration, which included tax cuts during a time of war and a floundering economy, are clearly the primary source of the current deficits. The Obama administration policies that are beginning to give the economy a needed jumpstart—the American Recovery and Reinvestment Act in particular—place a distant third in contributing to the 2009 and 2010 deficit numbers. The deficit picture for the years beyond still needs to be painted.

To come to these conclusions, we calculated the relative importance of the several factors contributing to the 2009 and 2010 deficits by looking at the impact in those

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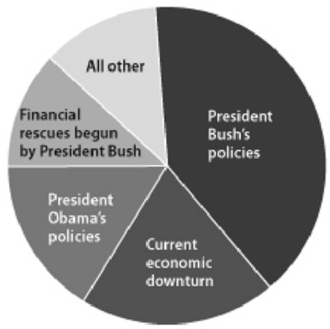
years of various policies. A detailed description of our approach is at the end of this column. Below is the percentage share of the major contributing factors to the total deterioration from the surpluses projected in 2000 to the current deficits according to our analysis. The policies of President George W. Bush make up the largest share, followed by the current economic downturn, and then President Barack Obama's policies.

Contribution to fiscal deterioration 2009 and 2010



President Bush's policies	40%
Current economic downturn	20%
President Obama's policies	16%
Financial rescues begun by President Bush	12%
All other	12%

Before explaining these further, it should be said that the generally worse deficit numbers reported today aren't all that surprising. Since the last projections in May, it's been plain that this recession has been worse than most analysts thought. With a weak economy comes lower tax revenue and higher safety net expenditures—with the loss in tax revenue causing the lion's share of the deficit problem. The effects of a deeper recession have a long-lasting impact. Even as growth is restored, it is growth from a reduced starting point—a smaller economy in 2009 usually means a smaller economy than previously predicted for several years hence.

Encouragingly, there have been signs of late that the administration's policies to end the recession are starting to take hold. Without such efforts, the picture would be much gloomier, particularly in the short term. One piece of good news is that the government is no longer expecting to spend another $250 billion rescuing financial institutions through the Troubled Assets Relief Program—which explains the improved deficit picture for 2009. And the projections for deficits in future years would be far more pessimistic if the American Recovery and Reinvestment Act policies were not starting to get traction.

As for the deficit's cause, the single most important factor is the legacy of President George W. Bush's legislative agenda. Overall, changes in federal law during the Bush administration are responsible for 40 percent of the short-term fiscal problem. For example, we estimate that the tax cuts passed during the Bush presidency are reducing government revenue collections by $231 billion in 2009. Also, because of the additions to the federal debt due to Bush administration policies, the government will be paying $218 billion more in interest payments in 2009.

Had President Bush not cut taxes while simultaneously prosecuting two foreign wars and adopting other programs without paying for them, the current deficit would be only 4.7 percent of gross domestic product this year, instead of the eye-catching 11.2 percent—despite the weak economy and the costly efforts taken to restore it. In 2010, the deficit would be 3.2 percent instead of 9.6 percent.

The weak economy also plays a major role in the deficit picture. The failure of Bush economic policies—fiscal irresponsibility, regulatory indifference, fueling of an asset and credit bubble, a failure to focus on jobs and incomes, and inaction as the economy started slipping—contributed mightily to the nation's current economic situation. When the economy contracts, tax revenues decline and outlays increase for programs designed to keep people from falling deep into poverty (with the tax impact much larger than the spending impact). All told, the weak economy is responsible for 20 percent of the fiscal problems we face in 2009 and 2010.

President Obama's policies have also contributed to the federal deficit—but only 16 percent of the projected budget deterioration for 2009 and 2010 are attributable to those policies. The American Recovery and Reinvestment Act, designed to help bring the economy out of the recession is, by far, the largest single additional public spending under this administration.

The cumulative cost of the financial sector rescue, mostly initiated under President Bush in response to the financial markets collapse, is also significant—contributing to 12 percent of the problem. A variety of other changes, described in the methodology section, are also contributors.

For the longer term, it's a bit disingenuous to assign any responsibility for the deficits. That's a story yet to be told, and CBO and OMB provide a selection of numbers to choose from for the long run. Much will depend on how the economy fares. If the Bush tax cuts, scheduled to expire at the end of 2010, were to be continued in their entirety there would be large deficits. If, as the Obama administration has proposed, they are only extended for those making under $250,000, then they still contribute to the deficit but not as substantially.

There are a number of similar budget items that have a long history for which one can, with equal legitimacy, assign responsibility to either their originators or current policymakers for continuing them. New Obama program initiatives, it's important to note, contribute little to future deficits. The administration has insisted that its additional spending, especially on health care, be fully paid for with savings elsewhere in the budget and additional revenues. In fact, to address our budget challenges it is critical to reform health care which, through Medicare, Medicaid, and other programs, is the single biggest budget headache in the long run.

Regardless of responsibility, of course, the long-run deficit situation is one that needs to be addressed.

METHODOLOGY

Contributors to the nation's fiscal situation in 2009 and 2010 (in billions of dollars), as measured against surpluses projected in 2001:

	2009	2010
President Bush's policies	−$923 billion	−$918 billion
Current economic downturn	−$426 billion	−$469 billion
President Obama's policies	−$225 billion	−$497 billion
Financial rescues begun by President Bush	−$422 billion	−$123 billion
All other	−$302 billion	−$262 billion

Three times each year, the Congressional budget office releases revised estimates of its budget projections going forward 10 years. In each of these revisions, the CBO describes how its current estimate has changed from its previous estimate, and why. By studying these estimates, we can attribute the change in the federal bottom line to various factors: specific legislative policies, changing economic conditions, and technical modifications.

Specifically, in January of 2001, just as President George W. Bush was taking office, the Congressional Budget Office projected that in fiscal year 2009, the federal budget would enjoy a $710 billion surplus. Today the Congressional Budget Office says that the budget will have a $1.6 trillion deficit, a swing of $2.3 trillion. Our analysis looks at the component causes of that swing.

Note that this is somewhat different than determining the sources of the deficit—the numbers we derive add up to more than the deficit because they include loss of surplus. It is reasonable, however, to allocate the costs pro-rata between the surplus reduction and the deficit increase. Thus, the percentages presented above can be fairly characterized as the percentage contribution of each factor to the deficits for each year.

In order to determine what caused that swing, we allocated changes in CBO's projections to one of five categories.

To President Bush we attributed all changes that CBO marked as "legislative" from its January 2002 update until its September 2008 update. We then modified this total in several ways. First, we subtracted more than $40 billion due to later revisions in CBO's estimate of the costs of Medicare Part D. CBO categorizes these changes as "technical."

Second, we added about $60 billion in costs stemming from the economic stimulus of 2008 that CBO also classifies as "technical." Finally, we adjusted downward the current cost of President Bush's tax cuts. CBO's estimates of the cost of President Bush's tax proposals for 2009 and 2010 were based on its economic assumptions for those years.

Because the economy is worse than CBO expected at the time it made those estimates, the cost of those tax cuts is also somewhat smaller than expected—as the tax system in general is producing less revenue, the cost of enacted tax reductions is less. To account for this, we adjusted the cost estimates of both the Economic Growth and Tax Relief Reconciliation Act and the Tax Increase Prevention and Reconciliation Act (the Job Growth and Tax Relief Reconciliation Act had no budgetary effect for 2009 and 2010) by the same ratio as CBO's GDP projections at the time and current projections. This adjustment has the effect of reducing the amount of the fiscal deterioration attributable to President Bush. We believe this is more generous to the former president's contribution to the current problems than a similar analysis recently conducted by The New York Times.

The impact of the current economic downturn was calculated by summing all of the changes attributed to "economic factors" in CBO's estimates from January 2008 through August 2009. To these we added revenue adjustments made in January and March 2009 that CBO classifies as "technical" but describes as being mostly due to economic changes.

To President Obama, we attributed all legislative changes since CBO's March 2009 update.

The "financial rescues begun by President Bush" category consists of expenditures stemming from TARP and the Federal Deposit Insurance Corporation, and from CBO's decision to bring Fannie Mae and Freddie Mac onto the federal books.

The remaining causes, including the economic changes from 2001 to 2007, CBO's technical changes not accounted for elsewhere, and policies enacted at the very end of 2008 (such as Alternative Minimum Tax relief) were allocated to "all other." We added $100 billion in additional expenditures for 2010 because CBO's baseline does not include an additional AMT "patch" for fiscal year 2010, though such a "patch" is exceedingly likely.

Ms. KAPTUR. And the committee is now adjourned.

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

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