LIFTING THE CRUSHING BURDEN OF DEBT

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LIFTING THE CRUSHING BURDEN OF DEBT

THURSDAY, MARCH 10, 2011

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

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

Present: Representatives Ryan, Campbell, Calvert, Price, McClintock, Stutzman, Lankford, Ribble, Flores, Mulvaney, Huelskamp, Young, Rokita, Woodall, Van Hollen, Schwartz, Kaptur, Blumenauer, Pascrell, Ryan of Ohio, Moore, Castor, Shuler, Tonko, and Bass.

Chairman RYAN. Let me just say, I am excited about this impressive list of witnesses we have. We have well-known, well-regarded witnesses on this issue. So I am really excited about getting into these details, and I am looking forward to this hearing. I will start with a brief opening statement then turn it over to my friend, Mr. Van Hollen.

This is an important hearing, basically on the future of our country. We here in Congress have our differences over how to solve our most urgent fiscal challenges, but I don't think that there is any serious debate over the urgency of these challenges. I doubt anyone here would dispute the fact that if we fail to act, we are inviting a debt crisis with potentially catastrophic consequences. Those seeking to cling to our unsustainable status quo are, quite frankly, putting us at the greatest risk.

Erskine Bowles, the Co-Chair of the Fiscal Commission, former Chief of Staff to former President Clinton, I think said it best, quote, The era of deficit denial is over. The failure to address the structural drivers of our debt has been a bipartisan failure over the years, yet the gusher of government spending and the creation of new, open-ended health care entitlements turned a fiscal challenge into a fiscal crisis.

The White House appears to acknowledge the problem, but seems determined to avoid tackling the problem. The latest budget proposal from the Obama Administration not only fails to address the drivers of our debt, but accelerates us down our unsustainable path. It would impose growth-killing tax increases and lock in Washington's reckless spending spree. Its claimed savings amount to little more than slogans and budget gimmicks. The status quo which the President's budget commits us to threatens not only our livelihoods, but ultimately our way of life. We must work together to lift this crushing burden of our debt.

The good news is this: We still have time to address the drivers of our debt and save our nation from bankruptcy.

We have several witnesses; we have experts today who will help us get our arms around the problem. I appreciate your testifying today before this committee on the difficulty and about the climb we have ahead of us. This is going to be a difficult climb. Our country is facing perhaps the greatest economic challenge in the history of our nation. But we do know that we can fix this. We do have time, and we can make this climb. The question is whether we have the political resolve to do that.

So the stakes of this challenge are no less than the unique American legacy of bequeathing to our children and grandchildren a better America; that is basically the legacy of this country. Each generation confronts its challenges in front of it, whether it is depression, world wars, or whatnot, so that their kids are better off. We know this. We know what is coming. The question is: Are we going to do what is necessary to prevent that from happening?

The way I look at it is, the worst experience that I have had in Congress was TARP. And I think most of us would probably agree with this. That is an economic crisis that caught us by surprise. We had all these meetings with the Federal Reserve Chair and the Treasury Secretary, talking about a deflationary spiral, a depression, bank failures were coming, and caught everybody by surprise. And I always ask people, What if your President and your member of Congress knew what was coming, saw it ahead of time, knew what they needed to do to prevent it from happening, but chose, instead, not to do anything about it because it was bad politics? Think about that.

This debt crisis is the most predictable economic crisis we have had in the history of our country. And if we actually don't do anything to prevent it from happening, shame on us. And this is the moment of truth. We have got to start talking about this stuff. And I hope that we can get there. I believe we can. Ultimately, the parties are going to have to come together to fix this problem, and I for one believe that the key is to go after spending. Spending is the driver of it. And if we do this, then our kids will have a better future. Then we will preserve the American legacy of leaving the next generation better off.

With that, I want to yield to my friend, the Ranking Member, Mr. Van Hollen.

[The prepared statement of Paul Ryan follows:]

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

Welcome all, to this important hearing on the future of our country.

We here in Congress have our differences over how to solve our most urgent fiscal challenges.

But I don't think there is any serious debate over the urgency of these challenges.

I doubt anyone here would dispute the fact that, if we fail to act, we are inviting a debt crisis with potentially catastrophic consequences.

Those seeking to cling to our unsustainable status quo are, quite frankly, putting us at the greatest risk.

Erskine Bowles, the co-chairman of the President's fiscal commission, said it best: "The era of deficit denial is over."

The failure to address the structural drivers of our debt has been a bipartisan failure over the years, yet the gusher of government spending and the creation of new open-ended health care entitlements turned a fiscal challenge into a fiscal crisis.

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The latest budget proposal from the Obama Administration not only fails to address the drivers of our debt, but accelerates us down our unsustainable path. It would impose growth-killing tax hikes and lock in Washington's reckless spending spree. Its claimed savings amount to little more than slogans and budget gimmicks.

The status quo, which the President's budget commits us to, threatens not only our livelihoods, but also our way of life. We must work together to lift this crushing burden of debt.

The good news is this: We still have time to address the drivers of our debt and save our nation from bankruptcy.

We have several expert witnesses here today who will help us get our arms around the problem. I appreciate your testifying today before this committee on the difficulty of the climb ahead and the consequences of inaction.

It will be difficult, but it is a climb we must make.

The stakes in this challenge are no less than the unique American legacy of bequeathing to our children a more prosperous nation than the one we inherited.

With that, I will yield to Ranking Member Van Hollen for an opening statement.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. And I want to join Chairman Ryan in welcoming our distinguished witnesses today. I am very pleased we are having a hearing on this important subject, and I think we can all agree that the long-term debt trajectory is unsustainable and unacceptable. And I believe we all agree that it is important to come together now, as the Chairman said, to develop and enact a sensible plan to reduce that debt in a steady and a predictable fashion. We should have a healthy discussion on what such a plan would look like.

What we should not be doing is taking actions that would hamper our fragile economic recovery. While last month's jobs numbers were promising, millions of Americans remain out of work. Enacting measures that would slow down job growth would not only impose additional and unnecessary economic pain on American families, it will harm the goal of deficit reduction. That is why the House Republican plan to make additional, deep, and immediate cuts in various investments in order to hit an arbitrary number is such a mistake.

Say what you will about Goldman Sachs, they know a little bit about the impact of investments, and their analysts predict that the House Republican plan will cost 700,000 Americans their jobs. Mark Zandy of Moody's Analytics, who, like Mr. Holtz-Eakin, was an advisor to the presidential campaign of Senator John McCain, reached a similar conclusion, as did the Economic Policy Institute.

Now, I see in Mr. Holtz-Eakin's testimony that you dispute some of those figures, and we can discuss them, but I would point out that the Chairman of the Federal Reserve, Ben Bernanke, testified just very recently that slashing the budget that way would, quote, Translate into a couple hundred thousand jobs, so it is not trivial, unquote. In fact, that would wipe out all the job gains from just last month. So the question is this: Whether the number of jobs lost is 200,000 or 700,000, why in the world would we be doing anything right now to cost thousands of Americans their jobs? That is a reckless and senseless approach that does virtually nothing to address long-term debt. And that is why the bipartisan fiscal commission that was charged with reducing our deficits specifically warned against that action right now.

Yesterday, the members of this committee had an opportunity to meet with Erskine Bowles and Alan Simpson. Here's what the bipartisan commission wrote in its report, quote, In order to avoid shocking the fragile economy, the commission recommends waiting until 2012 to begin enacting programmatic spending cuts, and waiting until fiscal year 2013 before making large nominal cuts, unquote. That is also what Bowles and Simpson said in their testimony before the Senate Budget Committee the other day, and that is what the bipartisan Rivlin-Domenici Commission recommended. They issued a similar warning.

So, Mr. Chairman, I am glad that, today, we are going to take a more comprehensive look at the budget situation, rather than focus only on the 12 percent sliver of the budget that includes critical investments in education, in scientific research and innovation, and transportation and energy infrastructure: investments that are critical to growing jobs in America, and winning in the competitive global marketplace.

As the bipartisan commission observed, a serious debt reduction plan will require a combination of spending cuts in discretionary and mandatory programs, as well as revenue increases. So I hope, Mr. Chairman, that this will provide an opportunity to take a, a serious and comprehensive look, rather than what many of us see as a short-term approach to hit an arbitrary number that will cost Americans their jobs. Thank you.

[The prepared statement of Chris Van Hollen follows:]

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

I join Chairman Ryan in welcoming our witnesses today. I am pleased we are having a hearing on this important subject. We all agree that our current long term debt trajectory in unsustainable and unacceptable. And I believe we all agree that it is important to come together now to develop and enact a sensible plan to reduce that debt in a steady and predictable manner. We should have a healthy discussion on what such a plan would look like.

What we should not do is take actions that would hamper our fragile economy recovery. While last month's jobs numbers were promising, millions of Americans remain out of work. Enacting measures that would slow down job growth will not only impose additional and unnecessary economic pain on American families; it will harm the goal of deficit reduction.

That is why the House Republican plan to make additional deep and immediate cuts in various investments in order to hit an arbitrary number is such a mistake. Say what you will about Goldman Sachs, they know a little bit about the impact of investments, and their analysts predict the House Republican plan will cost 700,000 Americans their jobs. Mark Zandi of Moody's Analytics, who like Dr. Holtz-Eakin was an advisor to the presidential campaign of Senator John McCain, reached a similar conclusion, as did the Economic Policy Institute. Now I see that Dr. Holtz-Eakin disputes these figures in his testimony. But the Chairman of the Federal Reserve, Ben Bernanke, testified last week that slashing the budget that way "would translate into a couple hundred thousand jobs. So, it's not trivial." That would wipe out all the job gains from last month. So the question is this: Whether the number of jobs lost is 200,000 or 700,000, why in the world would we be doing anything now that would cost Americans their jobs? That is a reckless and senseless approach that does virtually nothing to address the long term debt. And that is why the bipartisan Fiscal Commission that was charged with reducing our deficits specifically warned against such action. Yesterday, members of this Committee met with the co-chairs of the Commission, Erskine Bowles and Alan Simpson. Here is what the bi-partisan Commission wrote in its report: "In order to avoid shocking the fragile economy, the Commission recommends waiting until 2012 to begin enacting programmatic spending cuts, and waiting until fiscal year 2013 before making large nominal cuts." That is also what Bowles and Simpson said in their testimony before the Senate Budget Committee last week. The bipartisan Rivlin-Domenici commission issued a similar warning.

So I am glad that today we will take a more comprehensive look at what it will take to seriously tackle deficits and the debt rather than focus only on the 12% sliver of the budget that includes critical investments in education, scientific research and innovation, and transportation and energy infrastructure—investments that are critical to growing jobs in America and winning in the competitive global marketplace. As the bi-partisan Fiscal Commission observed, a serious debt reduction plan will require a combination of spending cuts in discretionary and mandatory programs as well as revenue increases.

I will close with this observation. In his recent testimony here, Jack Lew, the Director of the Office of Management and Budget, pointed out that when he had last appeared before this Committee as President Clinton's Budget Director, we were projecting a $5.6 trillion surplus. Today, we have with us John Podesta, who was Chief of Staff to President Clinton at that time. When President Obama was sworn in 8 years after Bill Clinton left office, he inherited a record annual deficit of $1.3 trillion and an economy in total freefall with more than 700,000 Americans losing their jobs every month. I make this observation to make this point—during the intervening eight years of the Bush Administration, some terrible decisions were made that wreaked havoc on the fiscal stability of our nation. If we are going to chart a fiscally responsible course, we are going to have to do many things, including reversing some of those fiscally reckless actions.

Chairman RYAN. Thank you, Mr. Van Hollen. I would simply just ask the witnesses, in the interest of time, because we have lots of members who have questions, if you could keep your opening remarks to five minutes, paraphrase your statements, and your written statements will be included in the record. I think we are just going to go left to right, right? So, Mr. Holtz-Eakin, why don't we start with you and then we will go on down the line.

STATEMENTS OF DOUGLAS HOLTZ–EAKIN, PRESIDENT, AMERICAN ACTION FORUM; CARMEN REINHART, DENNIS WEATHERSTONE SENIOR FELLOW, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS; MAYA MACGUINEAS, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET AT THE NEW AMERICA FOUNDATION; AND JOHN PODESTA, PRESIDENT AND CEO, CENTER FOR AMERICAN PROGRESS ACTION FUND

STATEMENT OF DOUGLAS HOLTZ–EAKIN

Mr. HOLTZ-EAKIN. Chairman Ryan and Ranking Member Van Hollen, members of the committee, thank you for the privilege of being here today. You have my written statement, I will be brief; I will make three points.

First is to echo the remarks of the Chairman about the seriousness of the situation, and the implications of the outlook for rising debt.

Second is to concur that the problem is spending, by almost any metric that has got to be the focus.

And the third is to address the concerns of the Ranking Member about the implications of cutting spending for near-term economic growth and jobs.

Everyone has a different way of saying this, but I believe we are at a juncture when America's prosperity and freedom is at stake. As I said in my testimony, there is a good news version of continuing down our current path. And in the good news version, massive federal borrowing is displacing investments in workers, in equipment, in innovation, productivity stagnates, wages don't grow, and we don't see the standard of living rise for a prolonged period, but we somehow muddle through and leave our children a diminished economy and, as the Pentagon folks would say, A diminished ability to project our values on the globe. That has been the core of our ability to protect our freedoms. That is the good news version.

The bad news version is one in which we actually get something that is 2008 or worse. We get a cataclysm in financial markets, we see sharp freezes in credit, main street economy collapses, and in the aftermath of that we still have the same problem to fix. So it is unacceptable, in my view, to continue down the path.

We have to change direction. We have lots of indicators that this is coming. Carmen's much more versed in the implications of rising debt to GDP levels, but ours is much too high. Moody's has put out an advisory on how they rate sovereign debt; and if you just take their technical criteria at face value, we are on track to be downgraded as a sovereign borrower in a matter of three or four years. And we have seen the borrowing around the globe.

So this is literally, as the Chairman of this Commission called it, a moment of truth, and a time to stop deferring the tough decisions that are necessary to get us on the right track. Those decisions are about spending. As the Congressional Budget Office's long-term budget outlook has said, again, and again, and again, for a decade, if you look at current policy in the United States, current law, spending rises under current law, above any sensible metric of the potential to tax. It rises to 35 percent of GDP or higher. It is driven by, largely, the entitlement programs, and especially the health programs. There is one, and only one, solution to that problem. You will not grow your way out of it, you will not tax your way out of it, you simply must modify those programs; entitlement reform is at the heart of getting this right. And we have done very little, in recent years, to do that. We wasted the decade we had before the baby boomers started to retire; they are now retiring. We went the wrong direction with the Medicare Modernization Act and Affordable Care Act, to add more health programs, not fix the ones we had. And now we are both out of time, and in the financial crisis, we have lost our cushion. The GDP has gone up by 20 percentage points.

The time is now to control spending. Now there are these concerns that somehow this is going to be bad for the economy, and I want to close with that. If you are a businessman in the United States right now, you are an international business trying to figure out where to locate, and you look at a country where the good news scenario is a future of higher interest rates, or higher taxes, or both, and the bad news scenario is a future that has a financial crisis followed by higher interest rates, higher taxes, or both. Why would you locate in that country, or why would you expand in that country? Why is that a good thing for the economic outlook? It is simply not.

So fixing that problem, undertaking control of the debt, is the single most pro-growth policy that Congress and the administration could undertake. And that will be at the heart of getting the economy going again, now, and in the future.

The kinds of studies we have seen, from Goldman Sachs and the man I made famous, Mark Zandy, have, at their heart, several problems.

Problem number one is that they get the magnitudes all wrong. The Congressional Budget Office estimates that out of HR-1, we would see a reduction of $9 billion in actual outlays in fiscal year 2011 from that bill, in a $14 to $15 trillion economy, this is peanuts; it will do nothing, with all due respect to the other economists.

Second is that not all outlays are purchases of goods and services. They make that mistake. A lot of them are transfer payments. And if you look around the globe at the evidence that has been accumulated, the successful strategy for growing and fixing a fiscal problem is to keep taxes low and cut transfer payments and government payrolls. That is the strategy that works; this is part and parcel of that strategy.

The third, and most importantly, the analyses are devoid of any capacity to change the outlook of individuals in the economy. They rule out anything that has to do with sentiment and optimism, and they, thus, rule out the very reason you are doing this. You couldn't possibly get another answer. So they are stacked against finding a beneficial conclusion. And I find it ironic that they are called Keynesian analysis, because John Maynard Keynes was a very sophisticated student of human nature, and put animal spirits and optimism at the heart of his economic theories. And so I disagree with the bottom line those analyses have. Thank you, Mr. Chairman. I look forward to your questions.

[The prepared statement of Douglas Holtz-Eakin follows:]

PREPARED STATEMENT OF DOUGLAS HOLTZ-EAKIN, PRESIDENT, AMERICAN ACTION FORUM*

Chairman Ryan, Ranking Member Van Hollen and Members of the Committee thank you for the privilege of appearing today. In this short statement, I wish to make the following points:

- The outlook for deficits and debt threatens the Nation's prosperity and freedom. Changing the fiscal course should be our top national priority.
- Controlling the growth of future federal spending should be the central objective of policymakers in pursing this goal.
- Effectively controlling spending, reducing deficits, and eliminating future debt accumulation can aid near-term economic growth.

Let me discuss each in turn.

THE THREAT OF FUTURE DEBT

The Fiscal Outlook. The federal government faces enormous budgetary difficulties, largely due to long-term pension, health, and other spending promises coupled with recent programmatic expansions. The core, long-term issue has been outlined in successive versions of the Congressional Budget Office's (CBO's) Long-Term Budget Outlook.[1] In broad terms, over the next 30 years, the inexorable dynamics of current law will raise federal outlays from an historic norm of about 20 percent of Gross Domestic Product (GDP) to anywhere from 30 to 40 percent of GDP. Any attempt to keep taxes at their post-war norm of 18 percent of GDP will generate an unmanageable federal debt spiral.

This depiction of the federal budgetary future and its diagnosis and prescription has all remained unchanged for at least a decade. Despite this, action (in the right direction) has yet to be seen.

Those were the good old days. In the past several years, the outlook has worsened significantly.

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*The opinions expressed herein are mine alone and do not represent the position of the American Action Forum. I am grateful to Sam Batkins, Ike Brannon, Cameron Smith and Matt Thoman for assistance.

[1] Congressional Budget Office. 2010. The Long-Term Budget Outlook. Pub. No. 4130. *http://www.cbo.gov/ftpdocs/115xx/doc11579/06-30-LTBO.pdf*

Over the next ten years, according to the Congressional Budget Office's (CBO's) analysis of the President's Budgetary Proposals for Fiscal Year 2011,[2] the deficit will never fall below $700 billion. Ten years from now, in 2020, the deficit will be 5.6 percent of GDP, roughly $1.3 trillion, of which over $900 billion will be devoted to servicing debt on previous borrowing.

As a result of the spending binge, in 2020 public debt will have more than doubled from its 2008 level to 90 percent of GDP and will continue its upward trajectory.

The President has now released his budget for Fiscal Year 2012. While CBO has yet to have the opportunity to provide a non-partisan look its implications, my reading of the budget is that it is largely replicates the previous year's outlook.

The "Bad News" Future under Massive Debt Accumulation. A United States fiscal crisis is now a threatening reality. It wasn't always so, even though—as noted above—the Congressional Budget Office has long published a pessimistic Long-Term Budget Outlook. Despite these gloomy forecasts, nobody seemed to care. Bond markets were quiescent. Voters were indifferent. And politicians were positively in denial that the "spend now, worry later" era would ever end.

Those days have passed. Now Greece, Portugal, Spain, Ireland, and even Britain are under the scrutiny of skeptical financial markets. And there are signs that the U.S. is next. The federal government ran a fiscal 2010 deficit of $1.3 trillion—nearly 9 percent of GDP, as spending reached nearly 24 percent of GDP and receipts fell below 15 percent of GDP.

What happened? First, the U.S. frittered away its lead time. It was widely recognized that the crunch would only arrive when the baby boomers began to retire. Guess what? The very first official baby boomer already chose to retire early at age 62, and the number of retirees will rise as the years progress. Crunch time has arrived and nothing was done in the interim to solve the basic spending problem—indeed the passage of the Medicare prescription drug bill in 2003 made it worse.

Second, the events of the financial crisis and recession used up the federal government's cushion. In 2008, debt outstanding was only 40 percent of GDP. Already it is over 60 percent and rising rapidly.

Third, active steps continue to make the problem worse. The Affordable Care Act "reform" adds two new entitlement programs for insurance subsidies and long-term care insurance without fixing the existing problems in Social Security, Medicare, and Medicaid.

Financial markets no longer can comfort themselves with the fact that the United States has time and flexibility to get its fiscal act together. Time passed, wiggle room vanished, and the only actions taken thus far have made matters worse.

As noted above, in 2020 public debt will have more than doubled from its 2008 level to 90 percent of GDP and will continue its upward trajectory. Traditionally, a debt-to-GDP ratio of 90 percent or more is associated with the risk of a sovereign debt crisis.

Indeed, there are warning signs even before the debt rises to those levels. As outlined in a recent report,[3] the credit rating agency Moody's looks at the fraction of federal revenues dedicated to paying interest as a key metric for retaining a triple-A rating. Specifically, the large, creditworthy sovereign borrowers are expected to devote less than 10 percent of their revenues to paying interest. Moody's grants the U.S. extra wiggle room based on its judgment that the U.S. has a strong ability to repair its condition after a bad shock. The upshot: no downgrade until interest equals 14 percent of revenues.

This is small comfort as the 2011 Obama Administration budget targets 2015 as the year when the federal government crosses the threshold and reaches 14.8 percent. Moreover, the plan is not merely to flirt with a modest deterioration in creditworthiness. In 2020, the ratio reaches 20.1 percent.

Perhaps even more troubling, much of this borrowing comes from international lending sources, including sovereign lenders like China that do not share our core values.

For Main Street America, the "bad news" version of the fiscal crisis occurs when international lenders revolt over the outlook for debt and cut off U.S. access to international credit. In an eerie reprise of the recent financial crisis, the credit freeze

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[2] Congressional Budget Office. 2010. An Analysis of the President's Budgetary Proposals for Fiscal Year 2011. Pub. No. 4111. *http://www.cbo.gov/ftpdocs/112xx/doc11280/03-24-apb.pdf*

[3] Moody's determines debt reversibility from a ratio of interest payments to revenue on a base of 10 percent. Wider margins are awarded to various governments to indicate the additional "benefit of the doubt" Moody's awards. The US finds itself on the upper end at 14 percent. The ratios are "illustrative and are not hard triggers for rating decisions." See: Aaa Sovereign Monitor Quarterly Monitor No. 3. Moody's Investor Service. March 2010.

would drag down business activity and household spending. The resulting deep recession would be exacerbated by the inability of the federal government's automatic stabilizers—unemployment insurance, lower taxes, etc.—to operate freely.

Worse, the crisis would arrive without the U.S. having fixed the fundamental problems. Getting spending under control in a crisis will be much more painful than a thoughtful, pro-active approach. In a crisis, there will be a greater pressure to resort to damaging tax increases. The upshot will be a threat to the ability of the United States to bequeath to future generations a standard of living greater than experienced at the present.

Future generations will find their freedoms diminished as well. The ability of the United States to project its values around the globe is fundamentally dependent upon its large, robust economy. Its diminished state will have security repercussions, as will the need to negotiate with less-than-friendly international lenders.

The "Good News" Future under Massive Debt Accumulation. Some will argue that it is unrealistic to anticipate a cataclysmic financial market upheaval for the United States. Perhaps so. But an alternative future that simply skirts the major crisis would likely entail piecemeal revenue increases and spending cuts—just enough to keep an explosion from occurring. Under this "good news" version, the debt would continue to edge northward—perhaps at times slowed by modest and ineffectual "reforms"—and borrowing costs in the United States would remain elevated.

Profitable innovation and investment will flow elsewhere in the global economy. As U.S. productivity growth suffers, wage growth stagnates, and standards of living stall. With little economic advancement prior to tax, and a very large tax burden from the debt, the next generation will inherit a standard of living inferior to that bequeathed to this one.

CONTROLLING SPENDING TO REDUCE DEFICITS AND DEBT

The policy problem facing the United States is that spending rises above any reasonable metric of taxation for the indefinite future. Period. There is a mini-industry devoted to producing alternative numerical estimates of this mismatch, but the diagnosis of the basic problem is not complicated. The diagnosis leads as well to the prescription for action. Over the long-term, the budget problem is primarily a spending problem and correcting it requires reductions in the growth of large mandatory spending programs and the appetite for federal outlays, in general.

As an example, using the President's 2011 Budget, the CBO projects that over the next decade the economy will fully recover and revenues in 2020 will be 19.6 percent of GDP—over $300 billion more than the historic norm of 18 percent. Instead, the problem is spending. Federal outlays in 2020 are expected to be 25.2 percent of GDP—about $1.2 trillion higher than the 20 percent that has been business as usual in the postwar era.

Just as some would mistakenly believe that the federal government can easily "tax its way out" of this budgetary box there is an equally misguided notion in other quarters that it can "grow its way out." The pace of spending growth simply must be reduced.

The Need for Rapid Action. The potential for a U.S. fiscal crisis is rising each day. This, it makes sense to quickly adopt reductions in annual discretionary spending to reduce future deficits. Discretionary spending is appealing as a starting point because it is the spending most easily and quickly modified by Congress. Any successful strategy will likely be built on three pillars:

- Rolling back spending to the "normal" funding levels preceding the financial crisis in 2008 and economic downturn;
- Adhering to a disciplined vision for a small, contained government. Such a vision would provide a demarcation between those things the government is uniquely equipped to undertake and those that are best not funded and left to the private sector; and
- Relying on strict oversight to defund those programs that do not effectively meet the government's service obligations.

At the same time, mandatory spending programs cannot be left to evolve as dictated by current law. It is equally important to quickly undertake entitlement reform. To see the need for urgency, consider first Social Security.

Social Security contributes to the current deficit. At present, Social Security is running a modest cash-flow deficit, increasing the overall shortfall. As the years progress, these Social Security deficits will become increasingly larger. They are central to the deficit outlook. More importantly, the stream of future outlays is heavily driven by demography. In particular, if the future benefits of the baby boom generation are exempted from reform, either by design or a failure to move quickly, then the outlay "problem" will have been effectively exempted from reform. This would be a fundamental policy failure.

For this reasons, an immediate reform and improvement in the outlook for entitlement spending would send a valuable signal to credit markets and improve the economic outlook.

Naturally, it would be desirable to focus on the larger future growth in outlays associated with Medicare, Medicaid, and the Patient Protection and Affordable Care Act (ACA). These share the demographic pressures that drive Social Security, but include the inexorable increase in health care spending per person in the United States. From a policy perspective, it would be desirable to replace the ACA with reforms that raised the efficiency of health care spending and slowed the growth of per capita health care outlays. At the centerpiece of such reforms would be reforms to the Medicare and Medicaid programs. However, in the absence of a political consensus to revisit the ACA, Medicare and Medicaid reforms will remain paralyzed and the most promising area for bipartisan entitlement reform is Social Security.

The Role for Tax Policy. While it will not be possible or desirable to rely on pure revenue increases to address the looming debt explosion, there is a role for improved tax policy to support economic growth. What is needed now is a tax policy that has incentives for businesses and entrepreneurs to locate in America and spend at a faster rate on innovation, workers, repairs, and new plants and equipment.

The place to start is the corporate income tax, which harms our international competitiveness in two important ways. First, the 35 percent rate is far too high: when combined with state-level taxes, American corporations face the highest tax rates among our developed competitors.[4] The rate should be reduced to 25 percent or lower.

Second, the United States remains the only developed country to tax corporations based on their worldwide earnings. Our competitors follow a territorial approach in which, say, a German corporation pays taxes to Germany only on its earnings in Germany, to the U.S. only on its earnings here, and so forth. If we were to adopt the territorial approach, we would place our firms on a level playing field with their competitors.

Proponents of the worldwide approach argue that because it doesn't let American firms enjoy lower taxes when they invest abroad, it gives them no incentive to send jobs overseas. Imagine two Ohio firms, they say: one invests $100 million in Ohio, the other $100 million in Brazil. The worldwide approach treats the profits on these two investments equally, wisely giving the company that invests in Brazil no advantage over its competitor.

But this line of reasoning ignores three points. First, because firms all over the world will pay lower taxes than the two Ohio companies, the likeliest outcome of the scenario is that both firms will fail, unable to compete effectively with global rivals. Second, when American multinational firms invest and expand employment abroad, they tend also to invest and expand employment in the United States. In the end, healthy, competitive firms grow and expand, while uncompetitive firms do not, meaning that our goal should be to make sure that American companies don't end up overtaxed, uncompetitive, and eventually out of business. And finally, because the U.S. is the holdout using a worldwide approach, it is at a disadvantage as the location for the headquarters of large, global firms. As the U.S. loses the headquarters, it will lose as well the employment, research and manufacturing that typically is located nearby.

The corporate tax should be reformed further. At present, companies must depreciate their capital purchases over time. Instead, they should be allowed to deduct immediately the full cost of all investments, which would provide a dramatic incentive for spending. We should also consider phasing out the tax-deductibility of the interest that companies pay on their borrowing. Because this interest is deductible and the companies' own dividends are not, firms have an incentive to borrow excessively. Removing that incentive—making a firm's tax liability dependent not on its financial decisions but on its real economic profitability—would discourage financial engineering and focus corporations on their core mission.

A more competitive corporate-tax system would be a good start in our effort to encourage private-sector growth. But a lot of private-sector economic activity in the U.S. isn't affected by the corporate tax at all. Activity that takes place in sole proprietorships, partnerships, and other "pass-through entities"—organizations whose

[4] Some defend the high corporate tax rate by arguing that the effective corporate tax rate is much lower. This misses an important point. Every country's effective tax rate is also lower than its statutory rate. A recent study by two economists at the University of Calgary (*http://www.cato.org/pubs/tbb/tbb—64.pdf*) concludes that the marginal tax rate in the U.S on new investment is 34.6 percent, higher than any other country in the OECD.

income is treated solely as that of their investors or owners—is instead affected by the individual income tax. Congress' Joint Committee on Taxation projects that in 2011, $1 trillion in business income will be reported on individual income-tax returns.

It's important to note that nearly half of that $1 trillion—$470 billion—will be reported on returns that face the top two income-tax rates. A conservative estimate is that more than 20 million workers would be employed by firms directly affected by those two tax rates. Tax reform should avoid higher marginal tax rates in favor of lower rates and a broader base. Marginal tax rates and the taxation of dividends and capital gains directly affect companies' decisions about innovation, investment, and savings.

Americans—from homeowners to small businesspeople to the millions of unemployed—are in desperate need of faster and prolonged economic growth. Congress should therefore evaluate tax proposals based on whether they're likely to trigger and support that growth. Tax policy can play a key role in spurring an economic recovery—but not without sustained reform of both the corporate and individual income-tax systems.

THE ECONOMICS OF SPENDING CONTROL

The top issue facing Americans is the need for robust job growth. According to the National Bureau of Economic Research the recession began in December 2007. Their data show that there were 142.0 million jobs in December of 2007—the average of payroll and household survey data. In June 2009, NBER's date for the end of the recession, the same method showed 135.3 million jobs, for a total job loss of 6.7 million attributed to the recession. These numbers are quite close to those using the Bureau of Labor Statistics non-farm payroll data, which showed a loss of 6.8 million.

There are glimmers of promise. Since December 2009, 945,000 payroll employment jobs have been added. However at the same time, there are 14.5 million unemployed persons in the economy and many more discouraged workers. Since the start of the recession the labor force has fallen by nearly 500,000.

For these reasons, the current unemployment rate of 8.9 percent likely understates the real duress. Using the BLS alternative unemployment rate (U-6), one finds that unemployed, underutilized and discouraged workers are 15.9 percent of the total. As evidence of the difficulties, the number of long-term unemployed (27 weeks or more) is currently 5.9 million and accounts for 43.9 percent of all unemployed persons.

The fiscal future outlined above represents a direct impediment to job creation and growth. The United States is courting downgrade as a sovereign borrower and a commensurate increase in borrowing costs. In a world characterized by financial market volatility stemming from Ireland, Greece, Portugal, and other locations this raises the possibility that the United States could find itself facing a financial crisis. Any sharp rise in interest rates would have dramatically negative economic impacts; even worse an actual liquidity panic would replicate (or worse) the experience of the fall of 2008.

Alternatively, businesses, entrepreneurs and investors perceive the future deficits as an implicit promise of higher taxes, higher interest rates, or both. For any employer contemplating locating in the United States or expansion of existing facilities and payrolls, rudimentary business planning reveals this to be an extremely unpalatable environment.

In short, cutting spending is a pro-growth policy move at this juncture. As summarized by a recent American Action Forum the research indicates that the best strategy to both grow and eliminate deficits is to keep taxes low and reduce public employee costs and transfer payments.[5]

Keynesian Arguments and Reducing Spending. Recent analyses of H.R. 1, the continuing resolution that called for $61 billion in reduced federal spending, by Goldman Sachs[6] and Economy.com[7] have been touted by some as evidence that it is not feasible to engage in spending reductions. I believe these arguments miss several key points.

The first thing to note is that while Members are aware that a reduction of $61 billion in budget authority does not translate into an immediate $61 billion cut in

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[5] See *http://americanactionforum.org/news/repairing-fiscal-hole-how-and-why-spending-cuts-trump-tax-increases*

[6] *http://blogs.abcnews.com/thenote/2011/02/goldman-sachs-house-spending-cuts-will-hurt-economic-growth.html*

[7] Zandi, Mark. 2011. A Federal Shutdown Could Derail the Recovery. Moody's Analytics. *http://www.economy.com/dismal/article—free.asp?cid=197630&src=wp*

outlays, many analysts appear to not understand these budgetary facts. Indeed, on average, a $1 cut would translate into only 52 cents during the current fiscal year.

To generate their estimates, Goldman Sachs assumed outlay reductions of $15 billion in the 2nd quarter and $30 billion in the 3rd quarter of calendar 2011. Naively interpreted, this could produce noticeable impacts on quarter-to-quarter GDP growth. But this is a misleading and highly overstated estimate of the likely impact because:

- The CBO estimates an outlay reduction of only $9 billion in fiscal 2011, or an impact of at most 0.3 percentage points;
- The calculation assumes full dollar-for-dollar reduction in GDP as spending declines. This is too large, especially because;
- Not all outlay reductions are actual cuts in the purchases of goods and services to contribute to measured GDP. Instead, some are transfers payments to states or individuals that will have a more muted impact. Indeed, while FY 2010 showed outlays of $3,456 billion on a budget basis, the National Income and Product Accounts[8] showed under 30 percent ($1,030 billion) as consumption purchases;
- Not all of the budget authority cuts are from new spending. Instead, some are rescissions of the authority for spending that never occurred and might never occur; and
- Most importantly this is a static calculation that assumes no beneficial offset in private sector spending because of the improved budget outlook and prospect of lower future taxes and interest rates. Put differently, the criticisms ignore the rationale for making these beneficial cuts to begin with: to clear the way for private sector jobs and growth.

A different way to make the last point is to note that these “Keynesian” arguments invoke a sterile, mechanical view of his economic views. In fact, Lord Keynes placed considerable importance on the role of expectations and optimism regarding the economic environment—so-called “animal spirits”. Policies that enhance the willingness and desirability of businesses to invest fit neatly in to his view of business cycles and economic growth.

Importantly, recent movements in indexes of economic confidence ranging from small businesses, to CEOs, to households have shown considerable improvement (See Table).

MEASURES OF ECONOMIC CONFIDENCE

	Jul '10	Aug '10	Sept '10	Oct '10	Nov '10	Dec '10	Jan '11	Feb '11
NFIB Small Business Optimism Index[1]	88.1	88.8	89	91.7	93.2	92.6	94.1	NA
Chief Executive CEO Confidence Index[2]	4.7	5	4.9	5.1	5.8	5.8	6.3	6.4
Reuters/Michigan Survey of Consumer Sentiment[3]	67.8	68.9	68.2	67.7	71.6	74.5	74.2	77.5

[1] http://www.nfib.com/Portals/0/PDF/sbet/sbet201102.pdf
[2] http://www.chiefexecutive.net/ME2/Audiences/Default.asp?AudID=328DCF73ACA1493ABBD34BF8AB37D74A
[3] https://customers.reuters.com/community/university/

No definitive explanation of month-to-month movements in measures of confidence will emerge from this hearing. However, I find it supportive of the basic argument that confidence improved markedly as the election and Congressional debate shifted toward control of future spending, deficits, and debt.

Two final aspects of the recent, Keynesian-based opposition to controlling spending are perplexing. Often those who make the claim that a $61 billion cut in spending will endanger the recovery are equally willing to argue that tax increases are needed to close the deficit. However, in a Keynesian model tax increases and transfer decreases enter in exactly the same manner. If the latter endanger the recovery, so must the former!

More importantly, entitlement reform—the repeal of the Affordable Care Act, Medicare reform, Medicaid reform, or Social Security reform—is likely to have no immediate impact on federal outlays. Instead, they are commitments in the present to reduced spending in the future. By construction, they can have no negative, Keynesian impacts on recovery. Instead, they carry only beneficial impacts on the expectations of employers and other market participants.

CONCLUSION

At this juncture, the United States needs a keen focus on enhancing the rate of economic growth. Workers and economy as a whole will benefit from pro-growth

[8] Congressional Budget Office. 2011. CBO’s Projections of Federal Receipts and Expenditures in the Framework of the National Income and Product Accounts. Pub. No. 4250.

policies. Central aspects of a pro-jobs and growth agenda are controlling federal spending growth; eliminating the potential for debt accumulation that generates a fiscal crisis, or higher taxes and interest rates; and improved tax policy.

I look forward to answering your questions.

STATEMENT OF CARMEN REINHART

Chairman RYAN. Thank you. Ms. Reinhart.

Ms. REINHART. Thank you, Chairman Ryan, and other members of the committee, for this opportunity.

Chairman RYAN. Please pull your mic right in front of you.

Ms. REINHART. The first part I would like to address is just put where we are a little bit in historic perspective, and then talk about the growth implications of where we are. As regard to where we are, historically, I would like to highlight that whether you look at gross debt, gross debt right now is 94 percent of GDP, the peak debt in 1946 was 121. But let's move on.

Let's look at what the Federal Reserve, the flow of funds include debts of the State and local government, and also federal enterprises, which now include Fannie and Freddie. That ratio of debt to GDPS of the third quarter is 122 percent, which surpasses the peak that we established in 1945.

Let me highlight that hidden debts are a big issue. And what do I mean by hidden debts? I mean contingent liabilities, and not just of the Social Security variety. There are huge contingent liabilities in the financial industry that we have to be aware of. If you don't think contingent liabilities matter, think of Ireland.

Let me proceed, very quickly, by saying that the march from financial crisis, to high public debt, to a public debt crisis, is the one that we are seeing unfolding in Europe. And that is what one could call debt with drama. And it is not over, and it has consequences for the U.S. Spain was downgraded overnight. The presumption that we are exempt from that pattern is a dangerous one, I would point out. It can happen.

But let's not go there just yet. Let's talk about where we are now and implications for growth. I have done work with Ken Rogoff that did a very simple exercise that looked at various levels of debt, and how it related to growth. We have found that years in which growth that is above 90 percent of GDP, median growth rates are about one percentage point lower. And this is based on post-war analysis. It includes 44 economies; it is robust, whether you look at emerging markets, whether you look at advanced economies alone, whether you look at the post-war, whether you look at longer periods. In effect, I want to highlight that the ECB and the IMF have done subsequent studies which actually clarify some of the areas, because our analysis, we do not pretend to do causality in our analysis. But the subsequent studies have taken that issue up. And there are two findings worth highlighting.

One is there is a strong negative causal relationship from high debt to lower growth. And secondly, those studies suggest, particularly the ECB study, which is for 12 European economies, ours is much broader, does suggest that the debt levels, the thresholds in which we placed at 90 percent, may be, actually, somewhat lower in the vicinity of 70 to 80 percent.

The bottom line is we have passed those thresholds, I think, without talking about drama, or default, or anything like that. I think the growth consequences are in the here and now.

Let me say something in what time I have left, that the contingent liability issue is a huge one. Right now, states also have what we call in the IMF "below the line financing." This is financing through arrears. Illinois, of course: six billion. None of these things are embedded in those debt figures, which are in the public domain. By the way, all the analysis that we have done, all this data is in the public domain.

So, without any melodrama, the debt numbers are considerably worse than the official estimate because we do have a lot of off balance sheet items that we need to be thinking about.

Let me conclude, then, on the same note as my testimony about a year ago before your Senate counterparts. At that time, I cautioned, it was premature to start cutting, because I was concerned about a frail recovery from a very severe financial crisis. But we are now, 2001, the crisis began in the summer of 2007, the clock has been running.

Let me conclude, then, the sooner our political leadership reconciles itself to accepting adjustment, the lower the risk of truly paralyzing debt problems down the road. Although most governments still enjoy strong access to financial markets at very low interest rates, market discipline can come without warning. Countries that have not laid the groundwork for adjustment will regret it. This time is not different.

[The prepared statement of Carmen M. Reinhart follows:]

PREPARED STATEMENT OF CARMEN M. REINHART, DENNIS WEATHERSTONE SENIOR FELLOW, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

Thank your, Chairman Ryan and the other members of the Committee for the opportunity to comment on the U.S. economy and the risks for the federal budget and debt. I am currently Dennis Weatherstone Senior Fellow at the Peterson Institute for International Economics. I suspect that I was invited to this hearing titled Lifting the Crushing Burden of Debt because, for more than a decade, my research has focused on various types of financial crises, including their fiscal implications and other economic consequences. Specifically, some of this work has focused on the historical and international evidence on the links between public debt and economic growth.

The march from financial crisis to high public indebtedness to sovereign default or restructuring is usually marked by episodes of drama, punctuated by periods of high volatility in financial markets, rising credit spreads, and rating downgrades. This historic pattern is unfolding in several European countries at present. That situation is far from resolved and remains a source of uncertainty for the United States and the rest of the world. However, the economic effects of high public indebtedness are not limited to turmoil in financial markets. Quite often, a build-up of public debt often does not trigger expectation of imminent sovereign default and the associated climb in funding costs. But in the background, a serious public debt overhang may cast a shadow on economic growth over the longer term, even when the sovereign's solvency is not called into question.

In a paper written over a year ago with my coauthor Ken Rogoff from Harvard University, we examined the contemporaneous connection between debt and growth. I summarize here some of the main findings of that paper and as well as our recent related work and relevant studies from the IMF and European Central Bank.

Our analysis was based on newly-compiled data on forty-four countries spanning about two hundred years. This amounts to 3,700 annual observations and covers a wide range of political systems, institutions, exchange rate arrangements, and historic circumstances. The annual observations were grouped into four categories, according to the ratio of gross central government debt-to GDP during that particular year: years when debt-to-GDP levels were below 30 percent; 30 to 60 percent; 60

to 90 percent; and above 90 percent. Recent observations in that top bracket come from Belgium, Greece, Italy, and Japan.

The main finding of that study is that the relationship between government debt and real GDP growth is weak for debt/GDP ratios below 90 percent of GDP. Above the threshold of 90 percent, however, median growth rates fall by one percent, and average growth falls considerably more. The threshold for public debt is similar in advanced and emerging economies and applies for both the post World War II period and as far back as the data permit (often well into the 1800s).

DEBT THRESHOLDS: THE 90 PERCENT BENCHMARK

Mapping a vague concept, such as "high debt" or "over-valued" exchange rates to a workable definition for interpreting the existing facts and informing the discussion requires making arbitrary judgments about where to draw lines. In the case of debt, it turns out that drawing the line at 90 percent was critical one detecting a difference in growth performance.

A hint about how important is that cutoff comes from the fact that countries rarely allow themselves to enter that high-debt range. Pooling the debt/GDP data for the advanced economies over the post-World War II period reveals that the median public debt/GDP ratio was 36.4. Fully three-quarters of the observations were below the 60 percent criteria in the Maastricht treaty governing the European Union. About 92 percent of the observations fall below the 90 percent threshold. If debt levels above 90 percent are indeed as benign as some suggest, one has to explain why they are avoided so often over the long sweep of history. (Generations of politicians must have been overlooking proverbial money on the street).

We do not pretend to argue that growth will be normal at 89 percent and subpar at 91 percent debt/GDP, any more than a car crash is unlikely at 54 mph and near certain at 56 mph. However, mapping the theoretical notion of "vulnerability regions" to bad outcomes by necessity involves defining thresholds, just as traffic signs in the U.S. usually specify 55 mph. Subsequent work suggests that we were generous in putting the threshold so high. An analysis at the European Central Bank, for instance, presents evidence that the negative impact of debt on growth may start at a lower 70-80 percent threshold for European countries.

DEBT AND GROWTH CAUSALITY

Our analysis looked at contemporaneous relationships between average and median growth and inflation rates and debt. Temporal causality tests are not part of the analysis. But where do we place the evidence on causality? For low-to-moderate levels of debt there may or may not be one. For high levels of debt, the evidence suggests causality runs in both directions.

Our analysis of the aftermath of financial crisis presents compelling evidence for both advanced and emerging markets on the fiscal impacts of the recessions associated with banking crises. There is little room to doubt that severe economic downturns, irrespective whether their origins was a financial crisis or not, will, in most instances, lead to higher debt/GDP levels contemporaneously and or with a lag. There is, of course, a vast literature on cyclically-adjusted fiscal deficits making exactly this point.

A unilateral causal pattern from growth to debt, however, does not accord with the evidence. Public debt surges are associated with a higher incidence of debt crises. In the current context, even a cursory reading of the recent turmoil in Greece and other European countries can be importantly traced to the adverse impacts of high levels of government debt (or potentially guaranteed debt) on county risk and economic outcomes.

There is scant evidence to suggest that high debt has little impact on growth. Kumar and Woo (2010) highlight in cross-country analysis that debt levels have negative consequences for subsequent growth, even after controlling for other standard determinants in growth equations. For a dozen European countries a study from the European Central Bank (Chechrita and Rother, 2010) provides further evidence of negative causality from debt to growth.

I will conclude on the same note of my testimony of about a year ago before your Senate counterparts. The sooner our political leadership reconciles itself to accepting adjustment, the lower the risks of truly paralyzing debt problems down the road. Although most governments still enjoy strong access to financial markets at very low interest rates, market discipline can come without warning. Countries that have not laid the groundwork for adjustment will regret it.

This time is not different.

STATEMENT OF MAYA MACGUINEAS

Chairman RYAN. Thank you. Ms. MacGuineas.

Ms. MACGUINEAS. Thank you. Chairman Ryan, Congressman Van Hollen, members of the committee, thank you for having me here today. You all know better than most the tremendous threats the United States faces due to our high debt load. In my written testimony, I go over a number of the numbers, including a realistic baseline that we put out that shows the problem is worse than you often see it looking at current assumptions.

Bottom line, our debt is unsustainable. Interest payments will be nearly $950 billion by the end of the decade, more than all domestic discretionary spending on its current path. And if we do not make changes, we will, at some point, face a fiscal crisis.

The solution is a multi-year, comprehensive fiscal plan that tackles each area of the budget. And the sooner we enact such a plan, the better. We face two paths. Under one, fiscal consolidation is used as part of an economic strategy that also includes preserving, and, in many cases, increasing, productive investments, and a sound safety net, and also fundamentally reforming our tax code to enhance competitiveness. The economy, the U.S. standard of living, and our well-being would benefit from having taken thoughtful preemptive actions.

On the other course, we delay due to the difficult policy choices and the political stalemate, and it causes the debt to continue to grow, which pushes up interest rates and payments, squeezes out our important priorities, chokes off economic growth, and it affects working families, and ultimately, it leads us to a vicious debt spiral which damages the entire economy, and the country. And under that scenario, we still have to make the same difficult spending and tax choices we face now, but they would be much larger and more painful.

So I will dig a little bit deeper into some of the areas that are threatened by high debt levels. There are five major ones: economic, budget, fiscal, psychological, and inter-generational. In terms of the economy, increased federal borrowing and debt will eventually crowd out private investment and lead to a smaller capital stock, lower incomes, a lower standard of living, and a lowering of our global competitiveness.

In terms of the budget, higher debt levels necessitate higher interest payments—which crowd out room for other spending priorities—and tax cuts. This will make our current battle over limited resources seem easy when compared to what we would be facing in the future.

The fiscal risk is that higher debt levels lead to reduced budget flexibility as interest payments grow to consume larger portions of the federal budget, and they compromise our ability to respond to future crises and opportunities as they come along. High debt levels are also psychologically damaging, contributing to business and household uncertainty, and harming our willingness to invest in ways that would spur the recovery. They also make planning difficult.

And I will just talk about one policy challenge. We know, in no uncertain terms, that changes need to be made to Social Security. We know that the sooner they are made, the better. And yet, for years and years of delay, it means that we are not letting current retirees, workers, or taxpayers know what the future holds for the program and its sustainability; and thus, they cannot plan accordingly. It is a terrible disservice to all participants of Social Security. The same level of uncertainty, of course, is there with regard to other needed policy changes that affect business owners, students, and normal families trying to plan for their future.

So finally, high debt levels not only threaten current standards of living, but the well-being of future generations. Higher borrowing today pushes the costs onto our children and grandchildren. So basically, we should just look our kids in the eye and say, Sorry we wanted to spend more today, and we didn't want to pay for it, so we are passing the bills onto you.

Ultimately, if changes are not made, the country will experience some kind of a fiscal crisis. And under such a scenario, creditors would demand spending or tax changes to set the new fiscal course. We would be doing it on their terms, not our own. No one knows exactly when this will happen, what it will look like, or what will set it off, but we know this: that the problem will not fix itself, and that without changes there will be some kind of painful crisis. It will be the worst of all worlds in terms of what it does to our economy, and all of our policy priorities.

So, in terms of a solution, I believe we need to adopt a multiyear, comprehensive budget plan to put the country on a glide path to stabilize the debt at a sustainable level. We probably want to bring the debt back down to around 60 percent of GDP over a decade, still significantly higher than our historical levels of below 40 percent, and then continue on that path to get us closer to historical levels.

While the debt threat is serious, it is also an opportunity to restructure our budget and tax system. In order to be competitive down the road, we must strengthen critical investments. By shifting our budget from a consumption-oriented to an investment-oriented budget, we could lay a new foundation for growth. Entitlement reform must be at the center of any turnaround plan. The largest programs in our budget that are growing faster than the economy: Social Security, Medicare, and Medicaid, must be reformed.

Finally, our tax code is simply a mess. There is over a trillion dollars of tax expenditures, which are truly more like spending programs in disguise. And we should look at reducing, if not eliminating, many of them, so that we can reduce tax rates, and more effectively encourage work and investment, while also helping to fuel growth and reduce deficits.

So while the policy choices involved in tackling and controlling the debt are not easy, they are far easier than what we will face if we continue to delay. It is our hope that we will spend this year developing specific options for tackling the debt, discussing the trade-offs, making the necessary compromises, and ultimately passing a multi-year plan to change course. This will reassure markets, provide families and businesses with the stability they need, and set us on a course for a much brighter economic future. Continuing to delay is obviously a very risky strategy. So thanks again for having me today.

[The prepared statement of Maya MacGuineas follows:]

PREPARED STATEMENT OF MAYA MACGUINEAS, PRESIDENT, COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET, THE NEW AMERICA FOUNDATION

Chairman Ryan, Congressman Van Hollen, Members of the Committee, thank you for inviting me here today to discuss the problems presented by our large and growing federal debt.

I am Maya MacGuineas, president of the bipartisan Committee for a Responsible Federal Budget and the director of the Fiscal Policy Program at the New America Foundation. I am also a member of the Peterson-Pew Commission on Budget Reform, which recently released two reports—Red Ink Rising and Getting Back in the Black, which focus on the need to adopt multi-year budgetary targets and automatic triggers to help improve the budget process, and which we believe can be a helpful part of fixing our budgetary challenges.

You all know better than most, the tremendous threats the United States' debt situation poses. Not only is our debt higher than it has ever been in the post-war period as a percentage of our economy, we are on track to continue adding to this debt indefinitely.

This year, public debt—the amount the U.S. government owes to domestic and foreign investors, and ignoring sums that the government owes to itself via intergovernmental accounts—is set to grow from $9.0 trillion, or 62 percent of GDP at the end of last year to $10.4 trillion, or 69 percent of GDP at the end of this year, according to the most recent projections from the Congressional Budget Office. By the end of the 10-year period, the debt will have grown to an astronomical $18.3 trillion, or 77 percent of GDP. Interest payments will be nearly $800 billion in that last year, or more than all domestic discretionary spending.

Yet even these assumptions are probably too optimistic. The Committee for a Responsible Federal Budget recently released its "Realistic Baseline", which includes more realistic assumptions about future tax and spending policies than the current law assumptions CBO is directed to follow.[1] Our baseline shows deficits growing to over $1.3 trillion, or 5.7 percent of GDP by the end of the ten-year window; debt growing to $21.8 trillion, or 91.5 percent of GDP; and interest payments reaching $947 billion in that final year.

FIGURE 1.—CRFB REALISTIC BASELINE

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	10-Year
					BILLIONS OF DOLLARS						
Net Interest	$264	$329	$406	$484	$569	$652	$727	$800	$880	$947	$6,058
Deficits	$1,103	$896	$821	$870	$1,006	$1,000	$1,037	$1,170	$1,267	$1,347	$10,516
Debt	$11,601	$12,581	$13,479	$14,427	$15,507	$16,596	$17,726	$18,990	$20,353	$21,798	N/A
					PERCENT OF GDP						
Net Interest	1.7%	2.0%	2.4%	2.7%	3.0%	3.3%	3.5%	3.7%	3.9%	4.0%	3.0%
Deficits	7.0%	5.5%	4.8%	4.8%	5.3%	5.0%	5.0%	5.4%	5.6%	5.7%	5.4%
Debt	73.9%	76.7%	78.1%	79.3%	81.0%	82.8%	84.7%	86.9%	89.2%	91.5%	N/A
Memorandum:											
CBO Baseline Interest	1.7%	2.0%	2.3%	2.5%	2.8%	3.0%	3.1%	3.2%	3.3%	3.3%	2.8%
CBO Baseline Deficits	7.0%	4.3%	3.1%	3.0%	3.4%	3.1%	2.9%	3.2%	3.2%	3.2%	3.6%
CBO Baseline Debt	73.9%	75.5%	75.3%	74.9%	75.0%	75.2%	75.3%	75.8%	76.2%	76.7%	N/A

I believe it is highly unlikely we would even make it to that point without experiencing some type of a fiscal crisis.

Under realistic assumptions, debt will continue to grow throughout and beyond the decade, rising to over 100 percent of the economy in the mid-2020s, to over 200 percent in the 2040s, and eventually to over 500 percent by 2080. Driving the

[1] Projections based on CRFB Realistic Baseline, which assumes the 2001/2003/2010 tax cuts are fully extended, war costs slowly decline, scheduled reductions to Medicare payments to physicians continue to be waived for remainder of the decade. After 2021, projections follow CBO Alternative Fiscal Scenario, except that revenues are allowed to rise slowly.

growth in debt will be the aging of the U.S. population, rising health care costs, and of course, spiraling interest costs.

Clearly, no country could sustain debt levels at such heights without destroying economic growth, eliminating vital investments, and slashing standards of living. But even at heightened levels of debt, like those the U.S. is currently experiencing in the short-term and increasingly into the medium- and long-terms, the economy and society at large can suffer.

The solution to all of the risks of higher debt is a multi-year, comprehensive fiscal plan that tackles each area of the budget. The sooner we enact such a plan, the better.

We face two paths. Under one, fiscal consolidation is used as part of an economic strategy that also includes preserving—and in many cases, increasing—productive public investments and a sound safety net and fundamentally reforming our tax code to enhance competitiveness. The economy and U.S. standard of living would benefit from having taken thoughtful preemptive actions. Under the other, we delay due to the difficult policy choices and political stalemate, which causes the debt to continue to grow, pushing up interest rates and payments, squeezing out more important priorities, choking off economic growth and affecting working families, and ultimately leading to a vicious debt spiral, which damages the entire economy and country. And under that scenario we still have to make the same difficult spending and tax choices we face now—but they would have to be larger and more painful.

I'd like to dig a little deeper into the problems caused by high debt levels:

1. Economic: Many noted economists and respected organizations, including the International Monetary Found (IMF) and the Congressional Budget Office (CBO), have conducted analyses on the effects of heightened debt on interest rates; inflation; incentives for workers, businesses, and investors; and economic growth in general. They have found that higher levels of debt do not bode well for continued economic strength or living standards.

Increased federal borrowing and debt would eventually crowd out private investment in potentially more productive ventures via higher interest rates for government debt. Down the road, the nation would face a smaller capital stock. This need not be the case if increased federal borrowing was directed toward investments on public capital with returns greater than or equal to returns on forgone private investments.[2] Examples of such investments could include infrastructure, research and development, and education. However, the U.S. budget is primarily a consumption oriented budget, with spending on health care and retirement costs far out stripping investments, and oftentimes, our public investments are not well-directed.

A smaller capital stock down the road would eventually cause incomes to fall, making future generations worse off. Lower incomes would reduce people's incentives to work. The combined effects of a lower capital stock and labor supply would harm economic output in the long-term and decreases U.S. global competitiveness.

Economists Carmen Reinhart, who is here today, and Ken Rogoff of Harvard University have estimated that debt levels of roughly 90 percent of the economy—looking at a broader measure of debt, which incorporates debts the government owes to itself—are correlated with lower annual economic growth of about 1 percentage point.[3] Likewise, economists at the IMF have estimated that a 10 percentage point increase in debt lowers potential output growth by 0.15 percentage point in advanced economies.[4]

Higher debt can also contribute to higher inflation, whereby deficits add too much to aggregate demand in a given time frame, lead monetary authorities to try to reduce the real value of debt by printing more money (often referred to as "monetizing" the debt), or lead some people to believe that monetary authorities could deliberately increase inflation.[5] Such outcomes would have obvious negative implications for business and investor confidence and economic growth, as well as many savers in society—in particular, the elderly.

2. Budget: Higher debt levels necessitate higher interest payments on existing debt. Last year, interest payments on our $9 trillion debt totaled $197 billion. By 2021, however, interest payments are projected to jump fourfold to $792 billion, according to CBO. If policymakers enact legislation that increases deficits and debt over the next ten years, interest payments will also increase by even larger factors.

[2] Other complicating factors are that larger budget deficits tend to increase private savings, for several reasons, and can help increase foreign investment, both of which can mitigate the negative effects of increased borrowing. However, CBO states that, overall, these factors do not reverse the conclusion that increased borrowing would crowd out private investment.

[3] Reinhart and Rogoff. Growth in a Time of Debt, January 2010.

[4] Kumar and Woo, Public Debt and Growth, July 2010.

[5] Sargent and Wallace (1981), Barro (1995), Cochrane (2010), cited in Kumar and Woo.

All of these scenarios assume rather favorable interest rates. As interest payments rise, they will squeeze out room for other spending priorities and tax cuts. This will make the current battle over limited resources seem easy when compared to what is looming in the future.

3. Fiscal: Higher debt levels lead to reduced budget flexibility as interest payments grow to consume larger and larger portions of the federal budget, and compromise our ability to respond to future crises and opportunities.

Policymakers would have limited resources to respond to unforeseen events, such as wars, humanitarian crises, and economic downturns. In 2008, public debt stood at about 40 percent of the economy, affording us the fiscal space to significantly increase spending and cut taxes to support an economic turnaround. Larger debt would have hindered such efforts, and threatens our ability to respond to the next emergency. By nature, these budgetary costs are unpredictable, both in timing and in magnitude. Living at our fiscal limits is an immensely dangerous way to operate the government given the many uncertainties the nation faces.

4. Psychological: Uncertainty surrounding the country's fiscal path is eroding confidence among businesses and individuals. They don't know what spending and tax policies to expect in the future, and thus cannot plan accordingly. If businesses and individuals do not know what spending cuts and/or tax increases they might face in the future, or even if the country might face a fiscal crisis of some form or another, they will be less willing to make longer-term investment decisions in our economy. As the economic recovery continues to lag, uncertainty contributes to the problem of how to encourage businesses to be the engine of growth.

A lack of confidence or certainty can stem not only from economic expectations, but also from policy uncertainty. Whether large spending cuts or tax increases, uncertainty over which spending programs lawmakers might eliminate or which taxes they might create or increase are not optimal for growth.

Just as one example, we know in no uncertain terms that changes need to be made to Social Security. We know that the sooner they are made, the better. And yet the years and years of delay means that current retirees, workers, and taxpayers, don't know what changes will be made to make the program sustainable, and thus, cannot plan accordingly. It is a terrible disservice to all participants of Social Security. The same level of uncertainty with regard to other needed policy changes affects business owners, students, and normal families trying to plan for their futures.

5. Intergenerational: Higher debt levels not only threaten current standards of living, but the wellbeing of future generations of Americans. Higher borrowing today pushes the costs onto our children and grandchildren. Each generation of Americans has passed on improved opportunities and standards of living to the next generation. But for the first time, our fiscal course threatens to burden our children and grandchildren with enormous debt and reduced opportunities for the future, as well as a lack of fiscal flexibility as we lock them into certain programs and large interest burdens.

Basically we should all just look our kids in the eye and say, sorry, we wanted to spend a lot but not pay for it, so we are passing the bills onto you. Good luck with that.

A FISCAL CRISIS

Ultimately, if changes are not made, the country will experience some type of fiscal crisis. Under such a scenario, creditors would demand spending and/or tax changes to set a new fiscal course. No one knows exactly when this will happen, what it will look like, or what will set it off. But we know this problem will not fix itself and that without changes, there will be a fiscal crisis.

A year ago, we held a conference on what a tipping point might look like. At this cheery gathering economists and budget experts in attendance noted that a crisis could take many forms, including scenarios ranging from a gradual rise in interest rates and slowing of economic growth, to a rapid crisis where investors pull the plug on an economy—with triggering events ranging from a credit rating warning, to state budget problems, to a totally unforeseen factor. There was general concern that markets were underestimating how soon such a crisis might hit, and that the greatest risk was that our economy is already negatively affected by high debt levels, and that a crisis could hit in the next few years.

Under an abrupt fiscal crisis scenario, the U.S. would not have the luxury of spreading fiscal adjustment out among a larger group of federal spending programs or taxes, or across more generations. Investors would force immediate spending cuts and/or tax increases, threatening our ability to protect the programs on which the most vulnerable in society rely. A fiscal crisis would surely exacerbate all the negative economic, fiscal, psychological, and intergenerational effects of high debt.

For older generations, a fiscal crisis would hurt job security and incomes, and threaten retirement security if federal spending on retirement programs or taxes had to be altered abruptly. For younger generations, a crisis would also threaten job opportunities, incomes, and affordability of big ticket items. Workers would have to expect to work much longer than their parents and grandparents' generations.

We can never be sure when we might confront such a scenario, but we know for sure that we would ultimately face some type of crisis. It is far better to make fiscal changes on our accord than have markets force changes on us.[6]

THE SOLUTION: A FISCAL PLAN

We need to adopt a multi-year, comprehensive budget plan to put the country on a glide path to stabilize the debt at a sustainable level. We probably want to bring the debt down to around 60 percent of GDP over a decade—still significantly higher than the historic average of below 40 percent, and continue on a path that leads us back down closer to historical averages beyond that.

All areas of the budget should be on the table. Spending caps on discretionary portions of the budget—including both defense and non-defense programs—, entitlement reform, and fundamental tax reform are critical for tackling the magnitude of future deficits.

The debt threat is serious, but it is also an opportunity to restructure our budget and tax system for the 21st century. In order to be competitive down the road, we must strengthen critical investments in infrastructure, high value research and development, and education. By shifting our budget from one based more on consumption to investment, we can lay a new foundation for growth.

Entitlement reform must be at the center of any turnaround plan. The largest programs in our budget that are growing faster than the economy—Social Security, Medicare, and Medicaid—must be reformed. Their open-ended growth is already squeezing out other parts of the budget, threatens to push up tax rates to truly damaging levels, and their automatic nature removes the critical oversight and evaluation processes that should be a central part of budgeting.

And finally, our tax code is simply a massive mess. It is littered with over 250 special credits, deductions, exemptions, and exclusions that cost us nearly $1.1 trillion a year. These "tax expenditures" are truly just spending by another name. By reducing, if not eliminating, many of them, we can reduce tax rates to more effectively encourage work and investment, while also helping to reduce deficits. Fundamental tax reform is key in turning our fiscal situation around and strengthening our economic well-being.

A comprehensive fiscal plan that stabilizes debt and then reduces it thereafter must be center to any economic recovery and growth strategy. The economy and private investment would become unburdened by debt, the country would have the budget flexibility to respond to emergencies and to invest in critical areas for long-term prosperity, investors would remain confident in our ability to repay our debts, and businesses and consumers would have certainty over future spending cuts and tax changes. Most importantly, we would be handing down even better opportunities to the next generation.

While the policy choices involved in tackling our out of control debt are not easy, they are far easier than what we will face if we continue to delay. It is our hope that we will spend this year developing specific options for tackling the debt, discussing the trade-offs, making the necessary compromises, and ultimately passing a multi-year plan to change course. This will reassure markets, provide families and businesses with the stability they need, and set us on a course for a much brighter economic future. Continuing to delay is a very risky strategy.

Thank you to the Committee for all your work on this and the opportunity to appear here today.

STATEMENT OF JOHN PODESTA

Chairman RYAN. Thank you. Mr. Podesta.

Mr. PODESTA. Thank you, Mr. Chairman, and Mr. Van Hollen, members of the committee, thanks for inviting me back to the committee. Mr. Chairman, you will be surprised to know that I agree with your goal in your opening statement. I, of course, disagree a

[6] CRFB, Fiscal Turnarounds: International Success Stories, February 2010.

little bit with the analysis of how we got here, so let me just start there and do it very briefly.

I was fortunate, as you know, to serve as President Clinton's Chief of Staff. When our administration came to a close, the budget outlook was very different than it is today. Although President Clinton did inherit a budget deficit of 4.6 percent of GDP and growing, by 1998 we had a balanced budget. We left the incoming administration with a balance sheet that was $236 billion in the black, the largest surplus since 1948. And CBO projected that by 2008, the federal government would essentially be debt-free on the policies then in place. By the time President Obama was sworn in, the deficit had already reached $1.2 trillion, a remarkable swing of 11 percent of GDP since our administration left office.

How did we get from record surpluses to record deficits? First, deep tax cuts especially for high earners in 2001 and 2003 dramatically affected the federal balance sheet. The wars in Iraq and Afghanistan, and a major new entitlement program, Medicare Part D, were enacted without being paid for. The predictable result was a swift return to massive deficits and a growing debt. By 2007, instead of being nearly debt-free, the federal government's publicly held debt had nearly doubled.

Second, near the end of President Bush's second term, the onset of the Great Recession made a bad fiscal situation worse. Tax revenues plummeted, and this is the point where I disagree with you, Mr. Chairman. In fiscal year 2009, they dropped to their lowest level since 1950, where they have stayed. In fact, decline in tax revenues between 2008 and 2009 were four times larger than the new spending passed during President Obama's first year in office. We are left with a serious mid-term deficit problem, as well as an acute deficit and debt outlook, and on that, I agree with the panelists.

The only way to improve our long-term budget outlook is to combine fiscal discipline, as we did in the 1990s, with policies that create robust economic growth. So while we must reduce wasteful spending and take bold steps toward fiscal balance, both today and in the long run, it is also clear that sudden drastic spending cuts to government programs to keep the wheels of our economy turning will cost jobs, stall the fragile economic recovery, and that is why we both supported at cap [spelled phonetically], targeted investments, but have also listed specific cuts.

We look for savings in every part of the budget because it is impossible to balance the budget by cutting non-security discretionary spending alone. Not only is this one area of spending decidedly not the source of our deficit problems, it is also home to the most important public investments that are fundamental to our future economic growth. And it adds, as Mr. Van Hollen noted, at less than 15 percent of the budget, there are just not enough non-security discretionary dollars to fill the budget gap.

Rather than limiting the spending discussion to one part of the budget, we should broaden it to include mandatory spending, defense spending, government efficiency improvements, and especially tax expenditures, as Ms. MacGuineas noted. Every year we are spending twice as much on tax expenditures, more than a trillion dollars, as we do on non-security discretionary spending. Yet many of these tax expenditures are wasteful giveaways. They provide the biggest tax breaks to those who need them the least. They are subject to much less scrutiny and oversight than spending. And some are so specific and targeted on such a few number of people, that I think it is fair to call them tax earmarks.

Finally, new revenue absolutely must be part of the solution. There is little hope for deficit reduction, no matter what the size in spending cuts, without looking to revenue side of the ledger. With so many challenges facing our country today, we have to continue to invest in infrastructure, in clean energy, and science, and innovation, and education, to keep our economy competitive, to support the middle class, to create jobs, and to get wages growing again.

As I go into in some detail in my written testimony, limiting federal revenue to the historical average, or some level slightly above that, is going to be insufficient to address the challenges of the day. In fact, the last time the historic level of revenue would have actually balanced the budget was in 1966. And both the country and the budget looked quite a bit different 45 years later, after we passed Medicaid and Medicare in particular.

So I urge the committee to scrutinize and realize savings from every part of the budget, including in entitlements alongside strategic investments in revenue. We have identified specific cuts in non-security discretionary spending, in unneeded Pentagon spending, in wasteful tax expenditures, in mandatory spending, in restrained health care costs, in addition to targeted revenue increases.

Our plan, and hopefully I think, the blueprint for this committee that you will put forward soon would bring the budget into primary balance where federal revenues equal program spending by 2015. I hope that you can meet that mark, and put us on a firm footing to fully balance the budget in the future. It enforces fiscal discipline through the proven mechanisms of hard but realistic discretionary caps, and a real and comprehensive PAYGO system. And will bring the budget closer to balance without the weighing or reversing the fragile economy we have fostered over the past two years. So, again, thank you, and I look forward to your questions.

[The prepared statement of John D. Podesta follows:]

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

Chairman Ryan, Ranking Member Van Hollen, and members of the committee, thank you for the opportunity to testify concerning America's deficit and debt challenges.

The broad contours of our long-term deficit challenge are well-known. Over the next several years, the eye-catching deficits during the Great Recession will subside, but deficits will not disappear. Over time, if nothing is done, those deficits will widen, causing us to take on an unsustainable debt burden, and forcing us to put an ever-increasing share of our national income toward servicing that debt, rather than making important investments in our economy and our people. This is clearly a future we must avoid.

But our long-term deficit dilemma is not, as is so often claimed, purely a "spending problem." There is no question that current projections of federal spending are alarming and clearly unsustainable. It is not the case, however, that all federal spending is contributing equally to that trajectory. In fact, most federal spending is actually expected to remain steady or even fall, as a share of the economy, over the next 10 years and beyond. The exception, however, is federal health spending, and to a much smaller degree, Social Security. This suggests that, far from being a “spending problem,” what the United States actually faces is an aging population, and a “rising cost of health care” problem.

That is why it is so important that Congress and the administration work diligently to implement the cost containment strategies and delivery reforms that were part of the Affordable Care Act. These reforms, along with the rest of the bill’s provisions, are projected to reduce the deficit by more than $230 billion over the next 10 years and begin to restrain the growth in health care spending.

We also have a problem on the other side of the balance sheet. While rising health care costs and an aging population will combine to drive up government spending, at the same time a stubborn devotion to a tax code riddled with inefficiencies and loopholes will ensure that the country takes on ever more debt to pay for even the most basic of public services. Those who would limit federal revenue to the “historical average” of 18 percent of gross domestic product are ignoring an important, inescapable reality: The challenges we face today and will face in the future are different from those we faced 50 years ago.

They are also ignoring the simple fact that this historical average level of revenue has always been inadequate, even by historical standards. In 45 out of the past 50 years, the federal budget was in the red. I am proud to have served as chief of staff to President Bill Clinton, who oversaw three of those five elusive budget surpluses. The last time that 18 percent of GDP in revenue would have been sufficient to balance the budget was 1966. The budget and the country looked quite a bit different 45 years ago than they do today.

Forty-five years ago, Medicare and Medicaid had just passed and total federal health care spending was less than 0.3 percent of GDP. We spent about one-fourth as much on veterans’ hospitals and medical care, in real dollars, as we do today. We spent about one-tenth as much on law enforcement. There was no school breakfast program, no Children’s Health Insurance Program, no Transportation Safety Administration, to name a few. These programs and services arose to meet new needs, like the need for greater airport safety, or as ways to address enduring problems like childhood and elderly poverty.

The underlying demographics of the country have also shifted dramatically and will continue to do so. In 1966, just 9 percent of the population was over the age of 64. Today, 13 percent of the population is. By 2030, that proportion is expected to rise to almost 20 percent. How could we realistically expect to meet the needs of a population in which one out of every five people is a senior citizen using revenue levels from a time when less than 1 out of every 10 was? Remember, too, that programs like Social Security, Medicare, and Medicaid have been remarkably successful. In 1966, nearly 30 percent of all senior citizens lived in poverty. Today less than 10 percent do. Unless we decide, as a society, that we no longer have a responsibility to ensure a secure retirement and adequate health care for all older Americans, that we would be willing to go back to the senior poverty levels of the early 1960s, then we will, necessarily, be required to spend more over the next several decades than we have over the past several.

Higher spending to meet new challenges is clearly nothing new. Neither is raising more revenue. Citing the postwar average of federal revenue makes it appear as if that level of revenue was constant during that period. It was not. In the 1950s, average annual federal revenue totaled 17.2 percent of GDP, but then increased in every subsequent decade of the 20th century. In fiscal year 2000, revenue peaked at 20.6 percent of GDP. Far from being constant or stable at 18 percent, there is a clear pattern of higher revenue in each new decade. The pattern held for five straight decades, and it was only broken by the massive tax cuts implemented by President George W. Bush.

Even slightly higher levels of revenue—the chairman, for example, has suggested 19 percent of GDP as a target—have been and would continue to be inadequate. Only five times in the past 40 years would 19 percent of GDP be sufficient to balance the budget. And that is before taking account of the major demographic and health care cost challenges we are now facing.

Unfortunately, there is no magic level of revenue or spending that will balance the budget now and forever. Fundamentally, we need to make budget decisions based on our current and future circumstances, not on our past ones. We must grapple with the real underlying causes, and offer real and specific solutions, to address our growing federal debt.

The Center for American Progress, since our founding eight years ago, has been consistent in calling for a national effort to address these long-term challenges. When we began, the fiscal discipline of the Clinton administration had been recently abandoned in favor of massive tax cuts skewed heavily toward the wealthy. These were enacted during a time of war with its attendant spending increases. Adding to the fiscal damage was a new domestic entitlement program, Medicare Part D, which was passed without adequate funding. The predictable result was a return to large deficits and an unprecedented run-up of debt. This was the fiscal situation before the onslaught of the Great Recession, which itself had a dramatic effect on the nation's bottom line. The combined effect of the recession and the poor fiscal stewardship prior to it was to pull our long-term deficit problems closer toward us and create an intermediate deficit problem to go along with the long-term one.

Over the past few years, the Center for American Progress has offered several specific plans for spending cuts and revenue increases that would put the country on a path back toward fiscal stability. We have also been glad to see others start producing similar plans that, importantly, have started to be as specific and detailed as ours. There appears to be a growing recognition of something that we have long believed: Once you get past political rhetoric, solving the deficit problem is going to be extremely difficult. There are simply no easy answers or magic bullets. Solving this problem will require careful consideration of all the options, a fair weighing of the costs and benefits, and compromise.

There is one additional prerequisite to achieving our shared goal of a more sustainable federal budget: a strong and growing economy. We should not labor under the illusion that we can grow our way out of our budget woes. But neither should we ignore the fact that without a strong economy, solving our fiscal problem will go from being merely very difficult to being truly impossible. Given this reality, we strongly believe that every care must be taken in the near term not to disrupt the fragile recovery. While we strongly believe in getting the budget back to full balance eventually, our initial steps must be measured.

The shock of vastly constrained government spending, in the immediate, would have undeniably deleterious effects on the wider economy. Analysts from Goldman Sachs recently estimated that the cuts contained in H.R. 1 would slice 1.5 to 2 points from economic growth in the second and third quarters of this year. Moody's chief economist Mark Zandi estimated that the cuts in the House bill would lead to a loss of about 700,000 jobs. Federal Reserve Chairman Ben Bernanke agreed that H.R. 1 would result in a "couple of hundred thousand jobs" lost.

Though estimates clearly vary on the magnitude, there is wide consensus on the general impact. And given the crucial moment that we now find ourselves in—with private sector job growth just beginning to expand—it would be counterproductive to deliberately undertake contractionary policies of this magnitude in the near term.

Instead, we should be focusing on putting in place policies that will bring the federal deficit down to sustainable levels in the medium term and full balance over the long term. During normal economic times, there is no good reason to take on debt to pay for the ordinary, day-to-day operations of the federal government. There is no need, however, to try to solve the entire budget deficit at one enormous stroke. Steady, clear, step-by-step progress toward the eventual goal is both more likely to ultimately produce success and has the great advantage of requiring less dramatic change in the intermediate period.

Eventually, balancing the budget is going to require some difficult spending cuts and tax increases that neither Republicans nor Democrats, nor the American public for that matter, seem ready to embrace. We commend the efforts of the bipartisan group of senators who are even now trying to develop a framework for solving our long-term budget problems. We are hopeful that their effort, building on the general framework of the Bowles-Simpson proposal, will yield results that will be acceptable to both parties and both chambers of Congress. But even if it proves impossible to achieve a consensus right now on all the elements of a long-term deficit budget plan, that does not absolve us of the responsibility to start down the path toward fiscal sustainability. That is why we should also agree to adopt an intermediate goal somewhere between here and full balance.

We suggest a path to put the federal budget into primary balance by 2015 as that intermediate goal. Primary balance is when total government revenues equal total government expenditures, with the exception of net interest payments on the debt. This equates to a deficit of about 3 percent of GDP. At that level of deficits, publicly held debt, as a share of GDP, ceases to rise. Getting to primary balance by 2015 will not be easy. With the deficit currently standing at just under 10 percent of GDP, reducing it all the way down to 3 percent will require not just a restored economy but some substantial policy changes.

Nevertheless, we can reach primary balance without the kind of dramatic, fundamental shifts in public services and the tax code that will likely be required to achieve full balance. And by doing so, we will stabilize the debt-to-GDP ratio, demonstrate our resolve, and buy ourselves some much-needed fiscal breathing room.

There are four basic steps that we must take over the next several years to reach that intermediate goal. First, Congress and the executive branch should focus intently on making government work more effectively, more productively, and more efficiently. Don't misunderstand. Eliminating so-called, "waste, fraud, and abuse," will not, by itself, solve our deficit problems. Not even close. Nor is it a simple matter to even determine what constitutes wasteful spending. Improving the productivity of the government, and identifying and rooting out inefficiency, will take a serious commitment and effort. The recent report from the General Accounting Office that identified dozens of areas of potential duplication in the federal government is a good starting point.

The real work of figuring out exactly which programs and services are successful and which are not begins now. At the Center for American Progress we have an entire project that we call Doing What Works, which is devoted this effort. Our premise is that the American people deserve a government in which every tax dollar is spent wisely, every program is held to clear standards, and everyone is accountable for achieving goals in an efficient manner. We believe that these efforts also have the potential to save billions, perhaps even hundreds of billions. We've already identified the potential for up to $16 billion in annual savings from modernizing government informational technology systems and another $40 billion from federal contracting and procurement reforms.

Though improving government efficiency and rooting out waste will save money, we cannot pretend that it will dramatically alter the trajectory of government spending. To do that, we need to take a hard look at all parts of the federal budget and not merely limit our attention to one small sliver. The recent focus on nonsecurity discretionary spending is badly misplaced. Nonsecurity discretionary spending makes up less than 15 percent of the entire budget, and it is actually projected to decline over time. These are not the programs and services that are driving up our long-term deficits.

On the contrary, this category is home to most of the vital investments that are the keys to our future economic growth: education, transportation and infrastructure, science and technology research, and services that foster competiveness and innovation. H.R. 1 would cut all of these substantially including $1 billion from Head Start, which would force 200,000 children out of the program; $700 million from grants to local school districts; and $500 million from teacher quality grants. It would slash $6 billion from science and technology research including reductions to the National Science Foundation, the National Laboratories, and more than third from the National Institute of Standards and Technology. It would even cut the Small Business Administration and the International Trade Administration—offices that seek to bolster American businesses and American exports.

The misguided limitation of spending cuts to just this one category forces these kinds of cuts to investments that are fundamental to our future economic growth. Not only will these cuts cause job losses right away, but they will drag down our economy for years to come.

And despite the name of the category, we also end up cutting a variety of services designed to keep every American safe as they go about their daily lives. H.R. 1 would mean cuts to meat inspections, to the Centers for Disease Control and Prevention, to poison control centers, to law enforcement grants to cities and towns, to the Consumer Product Safety Commission, and to the Federal Aviation Administration. Meat inspections and poison control are not the reason we face a budget deficit. But they are fundamental services that the American people expect out of their government.

By concentrating only on this one category of spending, we ignore the potential for savings in all other parts of the budget. The Department of Defense, for example, is certainly not immune from waste and excess. Over the past several years, the Center for

American Progress has released several reports detailing specific savings that could be had from the Pentagon's budget without weakening our national defense.

There is also no reason to exempt mandatory programs from scrutiny. The Center for American Progress has identified several programs that could be streamlined or scaled back. For instance, in a time of exceedingly high commodity prices and high net farm income, should we continue paying high direct agriculture subsidies? The Government Accountability Office recently reported that billions of dollars are wasted in improper payments in Medicare. Restricting our attention to nonsecurity discretionary spending leaves these inefficiencies in place and leaves savings on the table.

Similarly, we should not ignore those spending programs that operate through the tax code. These tax expenditures are economically equivalent to their direct spending counterparts, but they are generally subject to less scrutiny and evaluation. Some of them are so specific and target such a tiny number of people or industries that they are best thought of as "tax earmarks." A balanced approach to cuts should include close examination of all spending programs, including tax expenditures, to make sure they are achieving their goals efficiently and effectively. The days of hiding special spending programs deep in the bowels of the tax code have to come to an end.

We also need to return to the successful budget processes of the 1990s, which will help ensure that any steps taken in the coming years to restrain the deficit are not undermined by future Congresses. These processes include statutory PAY-GO, which the 111th Congress successfully reinstated, as well as meaningful caps on both defense and nondefense discretionary spending, enforced through sequestration. The lesson of the 1990s is that caps such as these can work, so long as they are not arbitrary or punitive. Successful budget enforcement processes should also include congressional rules that make it difficult to pass legislation that would increase the deficit. The Senate has such rules, and in the previous Congress, so too did the House. Unfortunately, the current House leadership has chosen to abandon those rules in favor of something they call "Cut-Go," whereby spending increases must be offset by spending cuts, but tax cuts do not need to be offset at all. This is a recipe for fiscal disaster. Allowing tax cuts to not be paid for will inevitably result in massive deficits, as President Bush's economic policies convincingly and repeatedly proved.

We must remember that the word "deficit" is not a synonym for "spending." The deficit is actually a product of a mismatch between spending and revenue. While improving government efficiency and subjecting all parts of the federal budget to close scrutiny will help in addressing one half of the deficit equation, we simply cannot afford to ignore the other side of the balance sheet.

This year, for the third year in a row, federal revenues will be at their lowest level, as a share of GDP, in nearly 60 years. While the effects of the recession explain much of the dramatic drop in revenues, the other culprit is repeated tax cuts. Going forward, the obvious first step must be to jettison the bonus tax cuts for the wealthy put in place under President Bush. During the last decade and before the Great Recession, average income for the richest 1 percent grew by more than 20 percent, while at the same time median household income actually fell. Those at the top also weathered the recent economic storm far better than the middle class, and they are recovering faster as well.

The enormous tax cuts bestowed on the very rich in 2001 and 2003 were a mistake then, as they were an important contributor to the unnecessary deficits of 2002 through 2007. Maintaining them is an $800 billion mistake now.

In our plan for reaching primary balance, we also recommend implementing a millionaires' surtax. This would be 2 percent on adjusted gross income over $1 million and an additional 3 percent on AGI over $10 million. This surtax would raise about $30 billion a year. Ideas like these should be part of the discussion, not least because a tax on millionaires is, as evidenced by a recent Wall Street Journal poll, the single most popular way to reduce the deficit.

Balancing the budget and reducing our debt burden is going to require making hard choices. But by approaching the issue in a balanced and measured way, it does not have to mean sacrificing our future economic prosperity or a robust safety net for the vulnerable. If we dedicate ourselves to scouring the government for efficiencies, to subjecting the entire federal budget to scrutiny, not just one sliver of it, and to raising the revenue that the 21st century requires of us, then we will be able to balance the budget and leave the next generation with a fiscal inheritance that we can be proud of.

Chairman RYAN. Thank you. First, let me just start off. You know, we obviously don't agree on everything, but I want to thank you for having been a member of the fiscal commission. Your think tank, Center for American Progress, actually gave us ideas. You know, you actually did a lot of work and a lot of research and you are contributing to the debate, and for that, I thank you. And some of them, believe it or not, I agree with. So, thank you for that.

I want to bring up the chart on the bond markets.

Figure 8

Source: PIMCO

I want to ask the economists, and there is a lot of members here, so give me the five minute deal, is that all right? So, let's do that for ourselves, because I want to get to people.

This is what the, PIMCO calls the ring of fire. This is rating our countries in this very dangerous debt zone. And the U.S.A. is right up there with France, Italy, Japan, Greece, Ireland, the U.K., Spain. Ms. Reinhart, do you see it this way? I understand PIMCO, which gives us this chart, dumped their Treasury bills in their major bond fund the other day. I am very worried this thing is starting to accelerate. And Doug, because you are an economist as well, what does this look like? What does a debt crisis look like? I mean, everybody says, debt crisis is coming. What does that mean, exactly? What form does it take place? What does it look like? And I am going to have to ask you the question which I know no one likes to answer: How much time do you think we actually have? I hear speculation from bond traders and economists. What is your speculation? And then I want to get to the non-economists. Not that that is a bad thing, but go ahead.

Ms. REINHART. [inaudible] was, was using some of our data. So, that tells you something about highlighting some of the same problems I was in my remarks. In terms of the timing: I tried to reiterate that you don't know when bond markets will turn, but I think the perception that we have, a five nice year window in which we can do things, we can wait for oil prices to be in the right place, is not in the cards.

How do debt crises build up? They build up with a lot of hidden debts, and if they were not hidden, we would know about it. That is part of the problem. When you see the build-up of a debt crisis coming, you also see build-up of arrears, which we are seeing, certainly, at the municipal level; we are seeing it at the state and local level. We see now, then, also, that the closer you get to surpassing any historic benchmark, which we have already done, when we take into account state enterprises, the closer you move to a downgrade.

Japan, which is a lender to the rest of the world, has already been downgraded several times. You don't get to a debt crisis with very predictable, unless you are shut out of the credit market, like Argentina was; we are not Argentina. But where we see it is in these hidden debts in which contingent liabilities continue to build up. The bottom line is that at the current pace, we do not have a five year window in which we can wait for the right opportunity.

Chairman RYAN. Dr. Holtz-Eakin.

Mr. HOLTZ-EAKIN. I concur with this analysis. The horizontal axis is what I talk about, prosperity, right? The more you public debt you have, you are crowding out the ability of people to get educations and do investments; so as you go out that way, you are imperiling your prosperity. As you go down the vertical axis and you are borrowing from abroad, that is, that is our freedoms. We are not going to negotiate with our bankers. And some of our bankers don't share our values. So that analysis is right.

What would it look like when it hits? Well, you know, you would see a spike overnight in Treasury borrowing costs. We have an enormous amount of Treasury financing this very short-term right now, and so essentially we are borrowing at teaser rates. They would bounce right up, we would have to refinance at much higher rates that would flow right through into every mortgage, every car loan, every interest rate in the economy, and you would see just a collapse in the economy.

So it would be a very painful, very shocking experience. And we have been through something like that. We don't want to do it again.

The last thing I would say is, people always want to say that the U.S. is different. You know, we are not being disciplined by bond markets, we are exempt, and I want to echo, you just can't believe that. I mean, Rudy Penner, who was the former director of the CBO, always says, We are the best-looking horse in the glue factory, and that doesn't mean we won't turn out to be glue. And it is very important that we not even test the notion that, somehow, as the world's largest economy or its reserve currency, we are exempt. We control our future. The indicators say trouble arrives soon, within five years, so let's not go there, and let's not find out if we really are different.

Chairman RYAN. Let me ask the two, because I want to be respectful of time, if neither political party, if neither the House, the Senate, or the administration proposes in the next year or two to fix this problem, does that send the signals to the credit markets that the Americans are done? That the Americans don't have this figured out, that the Americans aren't serious? And does that, therefore, accelerate a debt crisis?

Mr. HOLTZ-EAKIN. In my opinion, yes. I am terribly worried about this.

Chairman RYAN. I mean just showing political leadership buys us time. Is that your assessment?

Mr. HOLTZ-EAKIN. Absolutely. I want to echo what Maya said in her opening remarks. Fiscal security. A, it is the right thing to do for everyone now and in the future. B, it is analytically not hard.

C, it sends the right message to bond markets: that we are willing to take the country in a different direction. Do it, and do it tomorrow.

Ms. MACGUINEAS. I am going to first give a non-economist answer to your economics question. But when you are walking on thin ice, right, lots of things can cause it to crack. And so we are at risk for so many things right now, whether it is sovereign debt contagion, or something that goes wrong in the States, any of these landmines in the budget, the contingent liabilities that are there. PIMCO, when they start to get out of Treasuries, that sends major signals. Right? Everybody on Wall Street is looking; everybody around the world is looking at this right now. So suddenly, anything can make a change very, very quickly.

And the bottom line is even though our bond markets have looked like there is not a problem, and people keep saying, Look, rates are so low, what are you worrying about? As soon as you start to see the problem in the markets, it is too late to do this on our own terms. There is no excuse for not getting ahead of a crisis which you know is coming your way.

In terms of policy and politics, we know the policies are incredibly difficult, and we also know what is involved in them, and we can do it. And I encourage, you know, as many roadmaps, let's get them out there, as possible. We need to get to specifics. We are now past the point of just talking about this is a problem, and kind of worrying about it. We need to know we get the specifics on the table and figure out how to fix the problem, and we need to do enough this year, hopefully a comprehensive plan, but enough to make markets more confident in the political process.

When I talk to folks from Wall Street, and someone who runs the Committee for the Responsible Federal Budget, Wall Street people didn't used to care, really. It wasn't like the people who called all the time. And they do now. The markets are paying a whole lot of attention, and they really are worried about our political process in all of this.

So, I think there is no question that, particularly with the Fiscal Commission having come out with a solution, that if this all dies on the vine and nothing happens politically, the next two years is not okay. We can't delay until after the election; something has to happen before then to reassure markets, other countries, and everybody who is watching this, that we have the political ability to face up to these problems.

Chairman RYAN. I know we have gone over, but John, I do not want to stifle you, so please, go ahead.

Mr. PODESTA. Well, Mr. Chairman, I would note that I am more used to the fire than the ellipses on that chart. But I would say this: This is the year where we have to show, on a bipartisan basis, a determination to stop our debt from going up. And that has to be in the midterm. I suggested 2015, you may have a different year in mind, but I think if we can do that on a bipartisan basis and lock that in, get on a path so that our debt does not continue to grow, and then we could begin the tough path of bringing it down, bringing the debt down, hopefully getting on a path back to balance. We would have accomplished a lot. And that is going to require a balanced plan, and as I said in my opening comments, it can't just be in one narrow part of the budget. It is going to have to work across the entire federal budget.

Chairman RYAN. Thank you. Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. I want to join the Chairman in thanking all of you for your testimony. And, as I said in my opening remarks, this is a very important hearing. And I agree that we need to come together on a bipartisan basis now, to come up with a plan that shows we are going to reduce the deficits and debt in a predictable, sustained manner. So I think there is agreement on that.

As I said in my opening remarks, also, I do think it is risky to do anything that could weaken the economy during this very fragile time. And Chairman of the Federal Reserve, of course, Mr. Holtz-Eakin is the guy who is supposed to be expert in interpreting the animal spirits, in fact, every time he makes a comment, he has got to be thinking of the confidence levels. And when he says that he thinks that a reduction of the magnitude we are talking about in the Republican plan, in the time period that we are, would cost a couple hundred thousand jobs, and makes the point it is not insignificant. I do think, when we are measuring confidence in the economy in part by the month-to-month job numbers, if we start to see any dip in that it is a big problem for confidence; it is also a big problem for the people who have lost their jobs.

But here is what I would like to focus on for a minute. I want to accept the premise, absolutely accept the premise that, in order to get the deficit and debt down, we have got to reduce spending. We are going to have to reduce spending in discretionary programs, and we are going to have to do it in mandatory programs. So let's accept that premise, for many of the reasons we have talked about here. And we should come up with a plan to do that now.

But I do want to pick up on some of the remarks that Mr. Podesta made. Because it is absolutely true that when he and the Clinton Administration left office, they left with large projected surpluses, and now when President Obama was sworn in he inherited a $1.3 trillion deficit. The day he put his hand on the Bible, he had already had a record deficit for that year.

So, if I could start with you, Mr. Holtz-Eakin. Because when you left the Bush Administration and went to become the Director of the Congressional Budget Office, there were many who wanted you to do analysis that showed that the Bush tax cuts in 2001, at that time, actually paid for themselves. And you rejected that analysis. And as recently as last August, August 2010 you stated, and I am quoting, I have never been in the camp that believes that, quote, 'tax cuts pay for themselves,' unquote, there is no serious evidence to support that. I assume it is safe to say that you hold that same opinion today that you did in August.

Mr. HOLTZ-EAKIN. Yes.

Mr. VAN HOLLEN. Okay. Now, so on pages two and three of your testimony, you say that, for the past eight years, nine years, we have frittered away our time without addressing the problem. And you list three things that made the problem worse. Three things. You mentioned the financial crisis: no dispute there. You mentioned the prescription drug bill that was signed by President Bush, that was not paid for: no dispute there, that makes things worse. You mentioned the Affordable Care Act; I am not going to get into a big debate about that, other than to say, we have had this discussion in this committee, the CBO scored that it is 2010 in deficit reduction, and a trillion over 20 years, we throw that in.

No mention of, of the wars that we didn't pay for, and continue to pay interest on. But most importantly, as Mr. Podesta pointed out, no mention of the 2001 and 2003 tax cuts during the Bush Administration, which, of course, your former boss, Senator McCain, voted against, because of his concern about the impact on the deficit.

Now, in today's CBA, they just issued in January, they estimate that if you continue all the tax cuts—I am not proposing that we stop all the tax cuts, but just make the point here, they say in their analysis, if you were to return to moving from Clinton era tax rates to the Bush tax rates, we are adding $3 trillion to the deficit over the next 10 years, if you include the debt service: two and a half trillion dollars just because of the tax cuts, another half trillion dollars debt service.

So, my question is this: You have a reputation as a straight shooter. Seriously, now, how can you have testimony that doesn't even address the revenue side? And again, I understand we have got to get it, there is no dispute. This hearing is entitled, Lifting the Crushing Burden of Debt.

Mr. HOLTZ-EAKIN. Right.

Mr. VAN HOLLEN. How can you not even address that issue in your testimony?

Mr. HOLTZ-EAKIN. Right. Because I am not interested in relitigating history. I think the central problem we face is that, if you look forward 10 years, using the President's budget, or, or any other projection, those projections have the following character: They say, we are out of Iraq and Afghanistan; the financial crisis is a distant memory; we are back to full employment; and we are raising revenue that is well above historic norms, 19, 20 percent of GDP, and despite that we have enormous deficits, trillions of dollars, much of which is interest on previous debt, and so it is the future accumulation of debt, driven by that characteristic that concerns me. And at the heart of that is spending issues. And the additions to spending that have been most threatening have been those in the health area. We did the Medicare Modernization Act, and we did the Affordable Care Act. So that is how I got to that conclusion, it is very straightforward.

Mr. VAN HOLLEN. Well, let me just to follow up on that. And again, I am accepting the premise that we have got to deal with the spending side. What I find interesting is that even when you were at CBO, and you issued these reports, you showed that the consequences of going from the Clinton era tax rates to the Bush era tax rates had serious consequences on the deficit. And I just point out, in 2004, when you were here in a non-partisan capacity, testifying and making comments on the budget, you said, you weighed these two things. You weighed the positive aspects of the tax cuts, and then you counterbalanced that with the concerns with respect to the deficit.

And here is what you said. I am quoting: The cumulative corrosive impacts of sustained deficits in the face of a full appointment economy, would unbalance, make the extension of the tax cuts a, quote, 'modestly negative policy choice'?

Now, that was at a time when projected deficits and debt were a lot lower than they are now. And so we have the Fiscal Commission. The Fiscal Commission said we have got to look at these tax expenditures. By the way, the Fiscal Commission's baseline, the baseline assumes that we return, with respect to the high-income individuals, assumes that we return to the Clinton era tax cuts.

So, I guess my question is that, we are not disputing that spending is part of it. What accounts for this total reversal from 2004, when that was a, a modestly negative choice. In other words, continuing them, even though the projected deficits and debt were not as bad, and today.

Mr. HOLTZ-EAKIN. So, I don't remember the context; I was probably asked. I believe that it is important to identify the top priorities. And those are on the spending side, I won't repeat that. The second point, which I think, the Fiscal Commission has said very clearly, is that should it be the case that, collectively, we decide we are going to raise more revenue: the route is tax reform. Our tax system is deeply broken. I have a long discussion in my written testimony; I encourage you to read it. Simply raising tax rates, going back to the, to the Clinton era tax rates, is not a good solution to raising more revenue.

And the third thing I would say, a personal opinion in my judgment, is I am deeply concerned about the following phenomenon: We have a rising projection of spending that is undisputed. And we have this concern that the international community is going to just cut us off, and we will have a fiscal calamity. Well, suppose you raise taxes a little to run off concerns out there in the bond markets, but you don't deal with the spending problem. Well, everyone calms down for a couple years. You go forward, same problem arises, you bounce tax rates up a little bit, problem goes away for a little while. You go a couple more years, you bounce taxes up again. Pretty soon, you are jacking taxes up right along that projected spending route, and that takes you to 30, 40 percent of GDP. And you will, you don't have to be a crazy [unintelligible] setter, you will kill the economy.

So, I am just trying to lobby, in an undisguised fashion, for, A, good tax policy; I am all for that. But B, dealing with the fact that if you don't control spending, you are going to have enormously higher taxes come, one way or another, and that is a bad thing.

Chairman RYAN. Thank you. Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman, and thank you, panelists. Let me try and summarize what I think I heard a little bit from all four of you, and, frankly, from the Chairman and Ranking Member, too, that there is some disagreement as to how we got here, and that there is some disagreement on the weighting of the different elements of the solution. But that there is no disagreement that the solution has to involve basically all of the above: has to involve mandatory spending, discretionary spending, tax reform, and the revenue side, in one form or another. And that there is no disagreement that we are heading towards a debt crisis which, when the Chairman asked his question, What does it look like? I think I heard you all pretty much say, It looks really ugly. And maybe, this is my words, not yours, but maybe like September, October of 2008, only a lot worse. And that it is probably coming—we have five years or less to solve the problem. Did I misstate anything?

Okay. If that is the case, that we are facing a really ugly, ugly economic scenario, for anything that any of us in this room care about, and we have five years or less to deal with it. And the entitlements, mandatory spending, have to be part of the solution because they are such a large chunk of spending. Can we solve this without reducing costs of Social Security, Medicare, Medicaid, and the other entitlements, within the next five years? In other words, not changing things that might affect five years, or 10 years, or 15 years out, but reducing the costs of those programs within the next five years. And whoever wants to comment on that can comment. Yes.

Mr. HOLTZ-EAKIN. If I could, I mean, there are two kinds of urgency involved. Number one is the urgency I think we have conveyed about the debt crisis and the fact that reducing spending is going to have to be a comprehensive effort, so that would include the entitlement programs. The second urgency I try to describe this way: think of Social Security. I am 53 years old. I am the trailing edge of the baby boom generation. It has been conventional in Social Security reform proposals to exempt those in, for good reasons, or near retirement. And 55 has been the industry standard for near retirement. If we continue to do that, that means you have two years before I get grandfathered. If you grandfather me, you grandfather the baby boom, which means you have grandfathered the problem.

So yes, in the next five years, it is absolutely essential that we move, and move quickly.

Mr. CAMPBELL. Okay. Other comments on it, Mr. Podesta, did you, go ahead, oh sorry.

Ms. REINHART. Very briefly on the five years. I think there is a second scenario that I would like to put on the table, which is death by a thousand cuts. And it is still death. And that doesn't involve a big blowout crisis, but a stalling. And so, my own view is that when it comes to the budget we really should leave no stone unturned because of the orders of magnitude. And the need to act quickly, I think, is in my view, imperative. But your point about no stone unturned is, I think, called for, by the order of magnitude.

Lastly, let me say that the prospect of a delay does not necessarily mean that we are going to have a crisis tomorrow. And I don't know whether I am more worried about not having a crisis tomorrow or muddling through, in Japanese style, for the next 10 years.

Mr. CAMPBELL. Thank you. Mr. Podesta.

Mr. PODESTA. Mr. Campbell, I think the big numbers really, are on the health care side, and particularly in Medicare. So I think that continuing and accelerating, the President has some ideas in his current budget, on how to do that. Cost containment, on the health care side, both in the public programs and in the overall health care system, including in the private sector system, by changing the way we deliver health care, and reducing the overall costs. It is really, I think, the thing that is the most needed and it is going to do the most to contain the big surge in the projections that Mr. Holtz-Eakin talked about.

I don't think anybody anticipates that tax rates are going to climb to those levels. They never have, they never will. But they need to be consistent with the commitments we have at a time by 2020, 20 percent of our population is going to be over 65. And, as I noted in my testimony, in 1965 when Medicare and Medicaid was passed, nine percent was over 65. We are going to have to have revenue to do that, but we are going to have to have deep restraint.

With respect to Social Security, just very briefly, I don't think, in the short term, it really compounds this problem. It is a solvable problem. We have thrown out a full-blown plan to get to 75 years, at my center, have thrown out a full-blown plan to get to 75 years of actuarial integrity, and strengthen the bottom, restrain the top. It has some near-term effect on the deficit and debt, but not much.

Chairman RYAN. Thank you. Ms. Schwartz.

Ms. SCHWARTZ. Thank you, Mr. Chairman. And thank you, panelists. I think, pretty much, we have all talked. And I want to thank some of you, particularly, for the important work that you have done in helping to put out very clear ideas out there, about how we can, and must, reduce this deficit.

Let me just disagree, if I may, with the previous question, at least as a beginning premise that there is disagreement about how we got here. I think, except possibly for the first speaker, there has been pretty clear agreement about how we got here. The only reason to go back over that at all is that we don't repeat negative history, that we don't actually believe that tax cuts pay for themselves, which there is some agreement on. Or that it doesn't matter if we actually have two, three trillion dollars of unpaid-for war, or tax cut, or additional health benefits. I mean, it is really clear. I think all of you would agree, you are all nodding, that in fact the way we got here was, and the way this President inherited an enormous deficit, and a terrible recession that reduced revenues, were expenditures that were not paid for by the previous administration.

I know the other side doesn't want to hear that, but that is the reality. So we have inherited that problem. Tax cuts of a trillion dollars for the wealthiest two percent of Americans, that they want to continue unpaid for. The Part D prescription drug benefit for Medicare, which was the largest growth in the entitlement of Medicare: a trillion dollars, unpaid for; they don't want to talk about. We think we ought to do Part D, but we ought to pay for it. And, and of course the wars that cost us a trillion dollars.

So I think we have agreement on that. And we also have agreement that we have to tackle spending. And that includes the current year, which we have already offered and passed $50 billion this current year, almost $50 billion in cuts. So the issue really is going forward. Can we, and this is going to be a debate that is pretty clear, so they all want to know what your answer is. Can we solve the problem, the serious, serious problem of the debt this country is in, and the cost of the interest payments on that debt, simply by tackling twelve percent of our budget on spending cuts in non-defense discretionary?

That is, so far, the only action that the other side has taken, is to say we have got to have dramatic cuts in twelve percent of our budget. Not defense. Not on the tax side, tax expenditures, apparently, are not expenditures, as far as the other side is concerned. That is serious from our point of view. So my two questions are: Is it true that we can actually tackle this problem long-term by simply, and it is a big deal, cutting education, cutting infrastructure, cutting investments that the government makes today, in a fragile economy? Will that get us there.

And secondly, my question is: What if, in fact, we do nothing on investments for the future? Mr. Ryan talks a lot about investments for our children. We all make investments for our children; it is usually called education, helping them go to college, helping them be able to be prepared. What if our nation does nothing? What if the other side continues to reject the President's proposal that we not only cut, but we make investments for the future so we can grow economically in a global marketplace, that we can be economically competitive? Can we be the great country that we have always been, economically and politically, if in fact, we do nothing about investments for our future, to grow the economy?

So my questions are simple, and I am going to start with Maya, because you, I think, were very clear in articulating the importance of everything being on the table: tax expenditures, and spending, includes DOD, and making the investments. And I would like Mr. Podesta, also, to speak. So Ms. MacGuineas.

Ms. MACGUINEAS. Great. Thank you. I mean certainly when we think about where we have come from there is so many contributing problems to where we are, right? We ran deficits for a decade when we should have been running surpluses. You want to balance the budget over the business cycle, or something like that. So we came into this problem in a weakened fiscal state. We then were hit with a terrible economic downturn which caused us to enlarge our deficits, both because of the economy and the policy responses.

And now, the biggest problem that we face has always been there: the long-term spending problem fueled by health care and aging, which was a long-term problem, we delayed taking action, it is now at our doorstep. So we sort of are getting hit with all the fiscal problems you could have.

Ms. SCHWARTZ. I only, I only have a couple seconds left, but I wanted John Podesta to answer as well.

Ms. MACGUINEAS. Okay, well then let me quickly just agree with you in terms of investments, that absolutely, we should not be shortchanging the piece of our investment budget. We should expand this discussion beyond the twelve percent of the budget to the entire budget. But I also think we want to think about reorienting our budget. Because so much is focused on consumption; we need to think about retargeting inefficient spending and spending on consumption, and move it towards investment so those dollars are better spent in a time of fiscal austerity.

Mr. CAMPBELL [presiding]. Okay. Next. Mr. Calvert.

Ms. SCHWARTZ. Thank you.

Mr. CALVERT. Thank you. And I am an optimist by nature, but being on this committee, it is difficult.

You know, we talk about revenue and, of course, spending and I would remind the gentle lady that we may have cut $60 billion, but the United States Senate has not determined yet that we are cutting anything. So as Mr. Rayburn used to say, Our friends on the other side are our adversaries. The Senate is the enemy. So that is where we are at. I think we can all agree with that.

One thing I was looking at on the chart, the ring of fire: Italy, Japan, France, Ireland, U.K., Greece, and of course U.S.A. in the middle. One thing that you notice, or at least I notice on that chart, is that the one thing that U.S. has different than the rest of these countries is we have resources. And I look at the chart, the countries outside that chart, for the most part, Norway, the Netherlands, and Australia have resources. And the United States, you know, we are a country that puts extension cords out everywhere, you know, into the Middle East, and our friends in Canada and Mexico. And we extract resources from them, rather than from ourselves. And we have significant resources within our own country, and certainly in Alaska and in the upper State.

If, in fact, we are talking about revenues, and I just had a hearing the other day, I am an appropriator, I confess. But we were having a meeting the other day about the former MMS left $50 billion on the table in not collecting revenues from metal resource extraction. If, in fact, the United States went out after its own resources, extracting those resources, and the revenue that brings to the country, and obviously, national security benefits and the rest, don't you think that would be a significant part of turning this country around? I know the entitlement spending part is the biggest issue that we have got to deal with. But when you say everything is on the table, don't you think when we are paying $4 a gallon for gasoline, that that is a tax? That every consumer out there right now is paying a considerable tax because we don't face up to the problems in our own country, and developing our own resources? So with that, I will just leave it to the committee.

Mr. PODESTA. Well Mr. Calvert, I think that you put your finger on something that is really quite important, which is the interrelationship between our dependence on oil and the fact that 50 percent of our trade deficit comes from importing oil, and the ability to move to a different kind of energy base in this country, and what that would do for the economy. How it would spur innovation, job growth, and business formation.

I think the biggest place to look right now, in that regard, is both, clean technology, the kinds of things that are going to make the economy more efficient, including in the building sector as well as in the transportation sector; and then utilizing the vast resources we have of natural gas that are available to us, need to be done in a smart way. The New York Times has been writing a bunch of articles about what is happening in Pennsylvania right now. They need to be done in a smart way, but if we could move more of our transportation fleet to natural gas it would have a dramatic impact, I think, on our transportation sector, in particular.

And the problem with keeping, down the track, of just drilling for oil even in the Gulf, which you know, I think we need to do, is that it just keeps that dependence alive on foreign oil, which is at 60 percent now. So I think we need a comprehensive strategy to use all the resources that we have in our country.

Mr. CALVERT. I agree on all the above, I agree with you. Let's kind of move across here.

Mr. HOLTZ-EAKIN. I think two points. I mean, number one, I don't know the numbers on the receipts that would flow into the Treasury if we had greater exploration and extraction. I doubt it solves the problem.

Mr. CALVERT. I am not saying that it solves the problem.

Mr. HOLTZ-EAKIN. We have to be realistic. The second thing is that, in the end, our current account deficit is the difference between how much we save and how much we invest. And while, if we don't change how much we save and we don't change our investment, we can change the nature of our energy portfolio dramatically. We will just change the composition of our trade deficit. It will still be there. So we have to change the fundamentals. And our biggest problem with our saving is our federal budget deficit.

Mr. CALVERT. Well I would just make the point, if folks back home are spending four bucks for gas, they don't have a lot of money to save even for a pizza and a beer on the weekend. Thank you.

Mr. HOLTZ-EAKIN. The last thing to remember on this, and I know that time is up, is that if you are going to change the energy portfolio, that is costly. And we are coming out of a recession; and to change our energy portfolio dramatically is not a benefit, it is a cost. It might be worth it, we can have that debate. But let's be clear, it is a cost.

Mr. CAMPBELL. Thank you, Mr. Holtz, I am going to try and be a little ruthless on the time so we make sure we get to everybody. Mr. Blumenauer.

Mr. BLUMENAUER. Thank you. Although I would note that if we drain America dry of our oil it goes into a global pool. We only consume 20 percent of it; it is kind of goofy that we consume 20 percent of it. But it is a global price. And to the extent to which it drives anything down, most of the benefit will flow through the Chinese, to the Japanese, to the Europeans. I don't know that we are going to get anywhere on that. But I want to come back to gas prices in a moment.

But, again, the more I sit on this committee, and listen to witnesses like that, the more optimistic I get. Because having had a chance to look at various ups and downs in the government process over the last 40 years from all different levels, we end up affirming Churchill's aphorism that, You can rely on Americans to do the right thing after they have exhausted every possibility. I think we are reaching that point now on the federal level, and it is of a greater magnitude. But it seems to me that the whole issue underlying this is how we do business.

And I actually think there is a lot of agreement that is coming forward. I think there is an opportunity; I feel guilty for being away from a Ways and Means meeting right now where we are talking about tax reform. And I think there is an opportunity to change that system. I think there is a dramatic opportunity, in this Congress, to change how we subsidize agriculture in this country to help more farmers and ranchers, and spend less money doing it, with less market distortion. And I think there is bipartisan interest in pursuing that.

And I agree, Social Security, any 10 people around a Rotary Club table could, in 30 minutes and a website, can come up with three alternatives that are largely going to represent what we will ultimately do. I hope, and I agree with Ms. MacGuineas, let's get to some specifics.

And I would like to focus on one specific. Because for over 50 years, there has been an agreement in this country, going back to President Eisenhower, about a self-supporting trust fund for infrastructure investment. And that always, to this point, has been bipartisan. Ronald Reagan, in 1982, when economic times were tough, supported a five cent increase in the gas tax, a user fee that helped us move forward. Yesterday we had lunch with Senator Simpson, Mr. Bowles, and they had proposed a significant and periodic increase in the gas tax to be able to deal with both problems with that, and the fact that we are draining the general fund to prop up something that has been sub-supporting to this point.

We have record unemployment in the construction industry. We have infrastructure in every one of our communities that is falling apart, for roads, transit, and water. Isn't this an area where we could move forward with a tax increase or user fee that actually has broad support? This panel, in a prior hearing, had people from the Chamber of Commerce, AAA, and construction unions come in and testify in support of an increase. Is that part of a solution that might get us moving in this direction, put people to work, protect the budget deficit, and maybe even reduce some dependence on foreign oil at some point?

Anybody want to take that on the panel?

Mr. HOLTZ-EAKIN. So I will be brief. I mean, there was a report that came out of the bipartisan policy center from a commission that I served on two years on transportation reform. And I would encourage everyone to look at that. What it says pretty clearly is, number one; we have to reform the transportation programs, because we have never identified, what is really the federal role. We know that, in principle, infrastructure is important, but we have never decided what is the appropriate role for the federal government.

We have a hundred programs over there, and we proposed creating four. And then you have to finance them effectively. And I completely agree with that. One thing to note is that many people believe the gas tax itself is obsolete, and that we need to go to an alternative.

Ms. REINHART. Let me just point out that I think we have to be very discriminating and very clear about how we define infrastructure. Japan spent a massive amount on infrastructure in an effort to prop up the economy, and I am not an expert in that area, but it has to be very focused on productivity enhancements.

Ms. MACGUINEAS. Yes, I agree with so much of what you said. I think we need to focus far more on investment spending than consumption spending, and this is one of the more important areas. Second, we need to tax more the things we want less of, like pollution, through energy taxes, not the things we want more of, like work and saving. Third, I think the commission's proposal on how to not spend more than the tax raises, and to increase the tax to cover our highway costs and other transportation costs is a very good idea.

Fourth, I do think we have to make sure that what we do in terms of investment we do very well. We don't want to run the risk of suddenly calling everything investment, you know, farm subsidies, that is investment, and suddenly it loses all credibility. We want to do investment that really has productive payoffs.

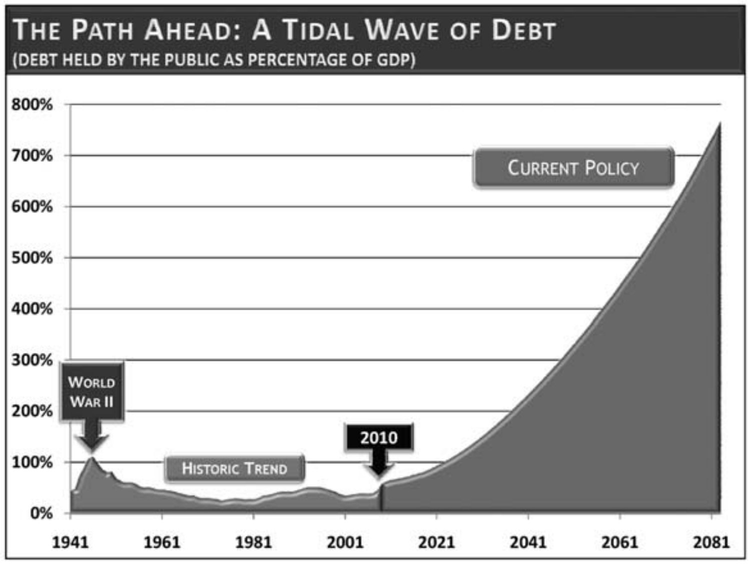
Finally, I want to increase investment spending, and I also, on the tax side want to do some, I would call, sweeteners. I want to lower the corporate tax rate. These are the things that I think should be part of a broad, comprehensive deal, as sweeteners, to help move them forward. I would be worried to do them on their own.

Mr. CAMPBELL. All right, thank you. Have to cut off now, and go to Dr. Price of Georgia.

Mr. PRICE. Thank you, Mr. Chairman. I want to thank the panelists as well. And I think there is a remarkable unanimity, as has been discussed, the need to address the spending side in both discretionary and entitlement, automatic spending, and how we get there is the challenge. It seems that every one of these comments in this committee starts with some finger pointing at the other side, and I would just remind my friends on the other side of the aisle that the Budget Committee's responsibility is to come up with a budget to provide direction for the country. And in the last Congress, of course, there was no budget. So as we grapple with these challenges, I think it is important to remember that.

I would also point out, and I don't know if we can bring up S6, but it is the deficit record by President. And, here it is. And you kind of bop along there for, for, with some deficits in the 200 to $400 billion range, and under a Democrat president and Republican Congress, we balanced the budget appropriately and had some surpluses. And then you see what has happened under the current administration. I think all of us can look at that, certainly the American people look at that and say, What the heck is going on?

In terms of, I don't know if we could put up S2, which is the tidal wave of debt that is coming, and the red chart here, the red line here that you can see, it increases astronomically, and clearly unsustainable. And then, finally, the issue that I want to get the panel to weigh in on is something that hasn't yet been talked about to a significant degree, and that is the issue of short-term debt and interest rates.



All of the presumptions, candidly, on both sides, have low interest rates. If interest rates increase any significant degree at all, then it blows up the models that all of us have. So I would ask you each if you would comment on the consequences of any increase in interest rates, and what, if anything, we are able to do about that.

And then, also, if you can touch on short-term debt, the chart that I had wanted to refer to has a significant increase in the short-term debt, the debt that comes due within a year to three years. And we are up in the 60 percent, or pushing the 60 percent range on that. What are the consequences of that? Is there anything that we can do about that? So if I could ask you to address interest rates and short-term debt, please.

Mr. HOLTZ-EAKIN. I will just be real brief. I mentioned this in my remarks, we have moved to very short-term financing, it is like financing on a teaser rate. And if we get a sharp spike, we are going to have to roll over a big fraction of Treasuries at much higher interest rates; that is going to feed through the budget, it is going to feed through all the interest rates in the economy, whether they are mortgages, or car loans, or anything else. So, we are exposed, both in terms of a financial management point of view, and also an economic point of view.

Mr. PRICE. And anything that we can do, I would ask to address that issue, as a Congress.

Ms. REINHART. Let me say that a characteristic, when Chairman Ryan asked, of what a crisis looks like, in the run-up to debt crisis, in the run-up to severe financial crisis, you see the rise of short-term debt, in total debt. That is worrisome. What has been done? Some of the stuff that was done was quite out of the picture now. In 1951, we actually had a debt conversion, called the Treasury-Federal Reserve Accord, which took marketable medium to short-term debt and converted it to 29-year bonds. Now we don't call that a restructuring or a default because an interest rate sweetener was offered. But it was, of course, under very different circumstances.

But what I am suggesting is that if we are faced with a sudden rise in interest rates, we may see a return of what is called financial repression. And captive audiences, like pension funds and financial institutions would be targets. It has happened.

Mr. PRICE. Maya.

Ms. MACGUINEAS. CBO recently, a couple years ago, I guess, did a great study on this showing the massive costs that are affiliated, I think it was at the request of Congressman Ryan, the massive costs that are affiliated with increases in interest rates. Obviously we are highly vulnerable to that; if you look at where we are right now. It is like a credit card teaser rate, right, it is luring us in, we are borrowing more, Look, rates are low, we can keep borrowing. When those rates go up, we are incredibly vulnerable.

There is another issue which I don't know exactly what to make of it, but when QE2 ends this summer, nobody knows exactly how that is going to play out. We don't know whether it is the flow or stock of debt that is going to have an effect. But we are more vulnerable than we would have been.

Third, you asked what we could do, and you made the first point. Stop finger-pointing and come up with specific solutions. It is the only thing we can do to be less vulnerable to the upward tick in interest rates.

Mr. PRICE. Great. John.

Mr. PODESTA. Well, I basically agree with Maya's points. I think that they, right now we don't see that spike in interest rates, but we are vulnerable to it. And I think we need to ensure, as I think Mr. Bernanke and the Fed have tried to ensure, that this recovery gets roots, that jobs begin to grow, that is the most important thing to, I think, solve both the debt crisis and the jobs crisis and the economic crisis, over the long term.

But I think the one thing that Congress could do is, you know, we are now repeating ourselves, is to come up with a framework in which the debt stops growing. And I think if you could do that on a bipartisan basis over the next couple of years, that would, I think, settle these markets down.

Mr. PRICE. Within the five year window. Thank you.

Mr. CAMPBELL. Thank you, Mr.Podesta; Mr. Pascrell of New Jersey.

Mr. PASCRELL. Thank you, Mr. Chairman. You know, I agree with my friend from Georgia that we can't point fingers. I would rather put it a different way, we need to put things in context. We need to put things in context so we understand. You know, sometimes I get the impression in this committee, and other committees that deal with the budget, spending, and revenue, that we are involved in a gigantic science project. And all science projects turn out very positive. They all do. But, you know, we can have brilliant results, it will have very little positive impact on the people we represent in reality.

See, I read a story this morning about a quadriplegic guy from New Jersey. His parents are fighting insurance companies over denial of 24 hour care. So, you know, we are not simply dealing in a numbers project here. We are dealing with human beings. And we have to deal with the numbers, there is no question about it. But those numbers need to be placed in context so we have a Gestalt, an overview of what really is happening.

We are all to blame, and we are all to gain. There is no one party that caused this mess. I think we all should agree on that; that is a good starter. But I look at reports, for instance, from the SMP indexes in the year ending December 10, health care costs covered by commercial insurance rose by 7.75 percent, as measured by the SMP health care economic commercial index.

Medicare claim costs associated with hospital and professional services for patients covered under Medicaid increased at a more modest 3.27 percent rate, over the ending, as of December, as measured by the, the SMP.

So, health care reform is important in the, quote unquote entitlement, or, better known, a sure objective, Obamacare, when you take a look at it; it is interesting. One third of that entire document talks about the budget, we need to put that budget together, dealt with Medicare and Medicaid. If we read the bill, all 975 pages, because our 2,200 page document was rejected, so that we really accepted the Senate version.

According to the CBO, the Affordable Health Care Act reduced deficits by $210 billion over 10 years, and by more than one trillion over 20 years, the most significant deficit reduction since 1997, the Balanced Budget Act, which I proudly, and some of us may have voted for.

So, Mr. Podesta, I have always enjoyed working with you because you are a pretty straight shooter, I think Mr. Ryan is a straight shooter, Chris is a straight shooter. But when you put things in context, we might come out with different answers, I think. We have been attacked, on our side, with accusations that neither we nor the President has come forward with proposals for entitlement reform, which we say, if we are going to look at everything in the budget, that is one of the things we will have to look at. We certainly need to look at it. I reject the claim.

Last Congress, we passed the Patient Protection Affordable Care Act. As I said, one third of it is devoted, if you read it, if you get a chance, in the document, I can list 17 places, Mr. Chairman, and the Ranking Member. Seventeen places. The first step of entitlement reform was received with attack ads claiming 500 billion in benefit cuts to seniors in death panels. I heard somebody mention death panels yesterday.

To date the only action this majority has taken at entitlement reform is repealing the reforms. So Mr. Podesta, are you familiar with the roadmap?

Mr. PODESTA. Yes, Mr. Pascrell.

Mr. PASCRELL. Mr. Podesta, are you familiar with how it proposes to control costs in Medicare?

Mr. PODESTA. It basically voucherizes Medicare.

Mr. PASCRELL. I am sorry?

Mr. PODESTA. It creates a voucher in Medicare. It essentially shifts costs from the federal government onto recipients.

Mr. CAMPBELL. Mr. Pascrell, your time has expired.

Mr. PASCRELL. Can I finish my sentence, my question?

Mr. CAMPBELL. Okay. But he won't be able to answer. I am just trying to get everybody a chance.

Mr. PASCRELL. Thank you. Has the cost of health care risen, as compared to inflation? That is what we are concerned about. And what happens in the voucher system is you never, ever, ever catch up.

Mr. CAMPBELL. Thank you, Mr. Pascrell.

Mr. PASCRELL. So let's be, put everything on the table in context, Mr. Chairman. Thank you.

Mr. CAMPBELL. Time has expired. Thank you, Mr. Pascrell. Mr. McClintock of California.

Mr. MCCLINTOCK. Well, Professor Reinhart, you mentioned that there has been one other time in our history when we had proportional debt. I am hoping that history offers us some lab notes. How did we get out of that? And we have also had several other spikes right after the Assumption Act in 1792; we suddenly had 35 percent debt. We were able to finance the War of 1812, and the Louisiana Purchase, and pay off all of that debt by 1830. What lessons can history offer us?

Ms. REINHART. Okay. Let me be very brief. One thing that makes the situation of more concern than the end of World War II, which was our last really big debt spike, is private debt. At the end of World War II we were lean and mean. Households and firms, financial and non-financial, were lean and mean. So it was exclusively a public debt issue. But public debt now is much more broadly defined. We have a lot of contingent liabilities.

But how did we get out of World War II, well, making cuts after war was a lot easier. But let me also say, I mentioned the issue of financial repression. That was actually a tax, but it was a tax that was never legislated. We kept interest rates very low through a lot of financial regulation. We created a lot of markets in the financial industry for holding government debt. That was a factor. We also ran balanced budgets for an extended period of time.

So you had the post-war reductions, which were somewhat more obvious than they are today.

Mr. MCCLINTOCK. About $85 billion.

Ms. REINHART. Indeed. There was a series of balanced budgets, even some surpluses. And there was a lot of financial repression; do not underestimate the power of that. It amounts to about three percent in revenues, meaning lower interest costs and actual liquidation of debt. That is how we got out of debt out of World War II.

Mr. MCCLINTOCK. So we had repressed demand, plus dramatic reductions in spending.

Ms. REINHART. Indeed.

Mr. MCCLINTOCK. And then actually produced balanced budgets. Which gets me to the next question, and that is, we talk about taxes and deficits as if they are opposite things. Aren't they really the same thing? Isn't the deficit is simply a future tax? Aren't those merely the two ways that we finance spending? And isn't spending the principle?

Ms. REINHART. And this is now seat of the pants because I have not tested this empirically, as I have other things, but one of the reasons why we find high levels of debt cause low growth, or associate it with low growth, has to do with anticipated future uncertainty, either of lower benefits or higher tax liabilities.

Mr. MCCLINTOCK. So, to borrow from the Clinton Administration, with obvious apologies, it is the "spending, stupid."

Ms. REINHART. The point I am trying to make is that the last time we were in this, we really did touch all bases. We had severe, or sharp spending cuts.

Mr. MCCLINTOCK. If I may, I am going to need to go to Mr. Podesta for a moment. Mr. Podesta, you mentioned that the state of the economy at the outset of the Clinton Administration, we were running huge deficits; we were in some economic difficulty. The Clinton Administration ended up reducing federal spending by a full four percent of GDP, which is miraculous, produced the only four surpluses that we have had in the last 40 years. It approved the biggest capital gains tax cut in U.S. history, it tackled entitlement spending with welfare reform. We were doing pretty well at the end of that administration, as you pointed out.

Mr. PODESTA. Well, I agree with that, Congressman. I think that was a combination. We did increase revenues in 1993, and painfully, because it led to, at least in part, losing both Houses of Congress in 1994, but they did increase revenues. But he did restrain spending over the whole period of time, and that resulted in an economy that produced 10 times as many jobs, much stronger wage growth.

Mr. MCCLINTOCK. Cut spending four percent. Now, George W. Bush takes office, and ends up increasing federal spending by a full two percent of GDP. He approved the biggest increase in entitlement spending since the Great Society, he embarked on massive stimulus spending, and as we all know, the condition of the economy and the budget wasn't so hot at the end of that experiment. So my question is why do we keep employing policies that we know don't work, and instead go back to those policies that your administration employed, by reducing spending, that the Truman Administration employed, that the Reagan Administration employed, all of which were marked by substantial economic progress and advancement.

Mr. CAMPBELL. Just to remind members, the five minutes includes the answer time.

Mr. PODESTA. Well, I will send you a note on that, Congressman.

Mr. CAMPBELL. All right. Mr. Tonko of New York.

Mr. TONKO. Thank you, Mr. Chair. Mr. Chair, I know that we have colleagues here from both sides of the aisle that share my appreciation for American history, and I would like to use my time here today to explore a few elements of our shared past.

Mr. Holtz-Eakin, certainly you were the director of the Congressional Budget Office from 2003 to 2005. The CBO, as we know, is a non-partisan institution. So I would like to highlight some of your non-partisan observations from that time, as I think they were insightful and fair, and have real meaning, I think, for the debate that we have here today.

This is a, a Washington Post article from January 27 of 2004, and CBO's annual budget report had just come out, under your direction, showing that the Bush Administration had asked for more than $1 trillion, had added more than $1 trillion to the deficit in just six months, and that that government debt could more than double if President Bush succeeded in making his tax cuts permanent. According to this article, you noted at that time that the massive deficits that would result from extending the Bush tax cuts, which were grossly skewed to favor the wealthy would, and I quote, lower national savings, reduce economic productivity, and ultimately, ultimately, curtail economic growth. Is that accurate?

Mr. HOLTZ-EAKIN. That is what I said, yes, absolutely, and I continue to worry about deficits; that is the implication to have.

Mr. TONKO. This is a Washington Post article from one year later, on January 27, of 2005. You were still at CBO, and due to the rising cost of the wars in Iraq and Afghanistan, the tax cuts for the wealthy, and a prescription drug plan that wasn't paid for, things were looking worse. You are quoted in this article in saying, again, and I quote, We are doing a little bit worse over the long term, and it is largely due to policy, policy changes. Could you tell me, is that quote accurate? And which political party was in charge of the White House, the House of Representatives, and the Senate at the time?

Mr. HOLTZ-EAKIN. I have no reason to believe it is not accurate, and Republicans controlled both Houses of Congress and the White House.

Mr. TONKO. Finally, this is an op-ed that you posted through your organization, the American Action Forum, just two weeks ago. And it reads, There has been talk that the House would pursue a series of short-term, two-week CRs, instead of a full-year CR. There could be no greater management nightmare than the inability to plan for more than two weeks at a time. And my point is that I agree with you on that point, certainly. And though we may not agree on everything, I think you have offered this chamber very sound advice in the past.

I was not here in 2004 and 2005, but I cannot help but think that if our leaders would have listened to you then, we might not be in the place we are in right now. Today our fiscal challenges are so great that the Republican leadership in our House is proposing calling for cuts to programs that range from preschool literacy programs, to senior health benefits. And yet, we still refuse to look at the policies that really got us here. And two wars on the credit card, the deregulation of Wall Street, and tax cuts for billionaires, simply didn't appear to be the formula for success.

No matter how many times we say it, the Koch Brothers are not a small business, and I do not believe they need taxpayer dollars to fund union-busting campaigns in Wisconsin. I don't believe it any more than I believe that if we are going to give oil companies bigger subsidies, they will someday become charitable institutions that won't gouge my constituents at the pump, and bring in record profits in the midst of the Middle East crisis.

Tax cuts for the wealthiest two percent of Americans were a bill of goods sold to us on the promise that they would create jobs, but even before the financial meltdown, they failed, at a cost of trillions of dollars. If we are going to spend that kind of money, America should be better for it. But while CEO pay doubles and triples throughout the decades, the purchasing power of the minimum wage has declined by nearly 10 percent. Where is that American? Where is that fair?

According to the CIA, the United States ranks 42nd globally in income and equality, putting us in the same range as Uganda, Nicaragua, and Iran. We cannot move forward this way and hope to compete economically with numbers like that. And we just need to address, I think, the inequitable treatment in our situation which has really seen a growth, exponentially, in the top one percent of wealth in this country and its income availability. And how can we go forward without strengthening a middle class in this country? It just confuses me economically, and irritates me programmatically. Thank you.

Chairman RYAN [presiding]. Thank you. Mr. Ribble.

Mr. RIBBLE. Thank you, Mr. Chairman. I have been listening, somewhat entertained here this morning, but disappointed in several ways with some of the hyperbole with massive tax cuts and all this kind of stuff, and how our deficit is because of massive tax cuts. And that revenue after the tax cuts in 2003, by OMB's numbers, went up in the next five years by 100 billion, 371 billion, 624 billion, 785 billion, 801 billion, and in 2010, after the global meltdown overnight, over 2003 numbers after the tax cuts, up 400 billion.

So, revenue is a difficult thing to really project what is going to happen, quite frankly. I have run my own business for 30 years. When we do budgeting I realize that a cut in spending is a direct savings, and something I can control 100 percent. I can choose whether to spend the money, or not to spend the money. I have the choice. I cannot choose whether a customer will buy from me, whether my business will grow. I can plan and strategize and try to do those things. And in the broad economic sense, addressing this strictly on the revenue side is nearly impossible. Not that it shouldn't be done, not that we shouldn't include that. But I do know that on the spending side we do have lots of control. And a dollar not spent is a dollar saved.

I actually have a question for Ms. MacGuineas. I appreciated your testimony a lot, and I want to give you a few minutes here to expound a little bit on something that I have talked about for about the last six months, and that is the psychology of the American consumer and the American business owner. You address it a little bit.

We have a psychological problem in this country and it relates to and affects economic growth, don't we? And could you talk a little bit about that? You didn't have enough time in your comments to do that.

Ms. MACGUINEAS. Great. Thank you for the opportunity, because I do think that the lack of certainty that surrounds businesses and households is certainly a factor in keeping the economic recovery from moving forward as much as we want it to. And if you look at, sort of, the ideal model for fiscal consolidation, and how to deal with the fact that we are also coming out of a very weak economy, most people have said that what we want to do is put in place a multi-year plan that doesn't have to phase in so quickly, because you can still leave some time for the recovery to take hold. So you wouldn't have to have tax increases or spending cuts very, very early on. We recommended starting them next year. As long as that plan was credible, and so that markets believed that that plan was going to be implemented.

I think that plan, to be credible, would have to be bipartisan, it would have to be put in statute, and it would have to come with budgetary triggers, so if those changes weren't made, that changes would come automatically. That would allow households to know what is going to happen. Importantly, because of all the capital on their balance sheets right now that would allow businesses to know what is going to happen.

If you look at part of the model in London, when they are, in England, going through their consolidation efforts, they have hoped that businesses would, kind of, be the drivers of growth, and fuel the recovery. There haven't been as many policies to help enable that, so you want to surround that with policies that allow businesses to help be an engine of growth in this recovery. We can't look to government to spend our way out of this, or households, who are over-indebted, to spend our way out of this. We do want businesses to be the engine of growth. None of that works in place, in terms of reassuring markets, letting households know what to expect, in terms of tax and spending policies, or having businesses invest in the longer term, unless we put in place policies that are credible, and likely to stay in place, and will put us on a glide path to something stable.

Mr. RIBBLE. How long have you been studying this topic, and this whole issue of economics here, as it relates to this budget crisis? Been a few years?

Ms. MACGUINEAS. It has been a few years. We haven't made that much progress.

Mr. RIBBLE. Do you think that, that the Congress has acted credibly in the past? Are there examples that we can point to that might help us?

Ms. MACGUINEAS. I mean, sure, the budget deals that we had in '90, and '93, and '97, all of those are different models, when we fixed Social Security, they were all different models for people coming together. There were a number of factors that made them work. You need leadership, you need real leadership. You need an understanding in the public of the problems and a commitment to fixing them. You do need bipartisan cooperation for anything that is hard, otherwise there is going to be immediate pressure to take back whatever policy changes you have put in place. And I do think that public component is actually quite important. You need people to understand.

Remember there was the Ross Perot moment; it kind of changed the whole world, right? But you need people to understand why this is something that you do for the country. And the narrative really has to be that this is part of a successful growth strategy. It is not just all about, you know, we are the eat your spinach crowd, it is not all doom and gloom though; it is about part of building a long term economic growth strategy in the country. And I think that has to be told to people, and then they are willing to step up to the plate and make those changes.

Mr. RIBBLE. That psychology will change, then, won't it?

Ms. MACGUINEAS. Absolutely.

Mr. RIBBLE. Okay. Thank you very much, and I yield back. Mr. Chairman.

Chairman RYAN. Ms. Bass.

Ms. BASS. Thank you. Ms. MacGuineas, I wanted to ask you a couple of questions. If I heard you right, I think you said, a few minutes ago in your presentation, that several events could tip us over the edge, seriously increase the crisis. And one of those events could be something going wrong in the states. And I really wondered, given what is happening in the states, what you meant by that, considering so many of the states are in such a deep crisis. California, a couple of years ago, had a budget of $110 billion: budget now is $83 billion, and we are facing a $23 billion deficit with no real clear way out of it. They are attempting a balanced approach in California, hopefully it will be voted on in the next week. But I wanted to know what you meant. What else could go wrong in the states that you are referring to?

Ms. MACGUINEAS. Well, there is certainly the situation that states may not be able to pay what they owe on their debt, and that this could be the beginning of a cycle of markets losing faith in the ability of the U.S. to make good on all of its commitments. There are also the structural problems in the states, which are a result of the economy. And then there are also the long-term problems, that we are all aware of, but their pensions and their health care commitments, which are obviously unsustainable. And again, much like what is going on at the federal level, this is a problem that we need to get out ahead of. This is a problem where they, these reforms need to take place in advance so that the states don't bump up against their limits.

Just one final problem with the states that we have been seeing is that the information, the data on the states is very, very poor. You can't make an apples to apples comparison of fiscal positions of various states. And so, transparency is a piece of all of this. We need to understand the fiscal well-being of the federal government and the states, and right now we don't have the information to do that.

Ms. BASS. Thank you. One other question. It seems as though, in several of your comments, that you were supportive of a balanced approach to us getting out of this crisis. And, on the revenue side, which I think we spend an awful lot of time talking about the spending side, and I would agree we certainly need to pay very careful attention to that, and rein in spending, but I don't think a whole lot is said on the revenue side. And it seemed as though, you talked about tax reform, and I know I have certainly attempted that in my time in California, and that is very big, very difficult to get to. So I would see that as a long term, and something that we definitely need to do. But in the short term, in terms of revenue, what suggestions would you have? And would you include, maybe closing some tax loopholes as part of it?

Ms. MACGUINEAS. Yes. I actually think that the answer to that question, what you would do in the short term, closing those tax loopholes, is in many ways the right start for the long term fundamental reforms, too. I think the fiscal commission put out a really, really smart structure, which said, let us show you how much we can bring rates down aggressively by clearing out all the trillion dollars in tax expenditures from the base.

Now, realistically, they are not all going to be cleared out. But, once you start funneling them back, and you say, well, we want part of this to still be there, or we want all of this to still be there, you bring up rates accordingly, and you actually have the cost of these. So we haven't had a budget for tax expenditures, they have been like mandatory spending, on automatic pilot. This creates a sense of the tradeoffs, and it certainly starts the, the right direction for fundamental tax reform, which is broaden that rate base as much as possible, bring rates down. And I believe you need to use a piece of that revenue to close the fiscal gap. And because tax expenditures are so big, there is actually plenty to do on both sides. So I think the framework by the fiscal commission is immensely helpful.

Ms. BASS. Thank you. We attempted the broadening in California, too, and everywhere you talk about broadening.

Ms. MACGUINEAS. Somebody likes that tax break, of course.

Ms. BASS. Exactly, it is so difficult. But in my remaining time, Mr. Podesta, you mentioned that health care spending was one of the drivers. And I wanted to know if, in the last few seconds, if you could give us your opinion as to whether or not the Affordable Care Act begins to address some of the concerns you raised around health care spending.

Mr. PODESTA. Well, Mr. Pascrell went through a list of the items in which there is restraint in the Affordable Care Act that begins to move that cost curve down. The CBO, as has been noted, estimates that it has some savings in the, in the near-term budget window, but over a trillion dollars in the second 20 years, which is really where the money is.

I think that the other place to look is to the CMS actuarial report from last summer, which indicated that health care spending would, would rise just slightly in the United States, by .2 percent, but include coverage for 32 million people. So I think that, at that point, the trend line is going down, whereas if you repealed health care, the trend line would continue to rocket up, as it has been for the last decade. So it is really important, I think, to be able to fulfill the authorities that are included in the Affordable Care Act, including the IPAB, the demonstration projects, changed the way we deliver health care, get on with trying to put more emphasis on primary care, try to get more errors, as the administration is currently doing, out of the system, so that we, across the board, in both the public programs, and in private sector health care, we begin to reduce the cost, which is extremely expensive, and not producing the results that we need.

Chairman RYAN. Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman. My colleague raises the issue of the balanced approach, which is something that we have been talking about as a committee, both within our party, and in a bipartisan basis. I think you have started to see in some of the discussion today that a lot of us agree that, in fact, I think Mr. Van Hollen actually said that we agree that we need to have some spending cuts. What is the right balance? I will put that question to each of you, very briefly. What is the right balance between spending cuts and revenue enhancements, to use a euphemism? Is it 50-50, is it 80-20, is it 110 with tax cuts? What is the right balance? Has anybody given that any thought? Let us go right to left because Mr. Podesta always gets left off at the end, and I am always good with starting on the right hand start of things.

Mr. PODESTA. Thank you. I think that the right balance is probably in the arena of 50-50. I think that the Simpson-Bowles was two-thirds, one-third. I am looking more at the near term, at the course of the next five years; it is probably in the range of 50-50. Over the long term, particularly as we get these health care costs under control, it shifts, and begins to probably look more like two-thirds, one-third. Two-thirds on the spending restraint side, one third on the revenue side.

Ms. MACGUINEAS. Great question. When you think about balance, two things complicate it; baselines, what baseline are you using, and how you allocate interest. I look at this as, actually, you could solve the problem on the spending side alone, but nobody wants to. There is not a politician who is talking about what you would have to do to current retirees. So we might as well get realistic, that revenues have to be part of it. And I think one of the keys is that that has to be combined with very serious structural reforms to entitlements. And there has to be an understanding that those revenues are going to close the fiscal gap, not to funnel into new spending. And then I think we can start being more realistic about that.

I don't think 50-50 is the right balance. I think, if you look at the problem, it is a spending problem, if you look at where the growth in the budget is, and compare it to historical averages. But since no one is willing to close it completely on the spending side, I think you start at, maybe, 80-20, and you end up at, maybe two to one. And you, you do what you have to do to get it done. But the problem is a spending problem, and both are going to have to be on the table for the solution.

Ms. REINHART. Two-thirds, one-third. And I say that on the basis of, simply, demographics. And this is not a short-run issue, but a medium-term issue. And a lot of our problems have to do with an aging population; this effects both the health and the social security side.

Mr. HOLTZ-EAKIN. I don't think you should frame the question that way. I really don't. I think we get lost in a, in a debate over whether the number is eight or nine, we lose our way. We need to rethink the government budget from top to bottom, identify those things the government can and should do, their traditional roles, fund them effectively, and, and build a vision for growth and opportunity, and articulate that. And there is nothing right now that is going to produce growth or opportunity. Congresses of both parties have a long history of spending tons very ineffectively and not funding them adequately. That has got to change. Spend the money effectively; fund it adequately. And let us, let us get started fast.

Mr. MULVANEY. And here is why I asked the question, and I appreciate that. But, if you look at it historically, no one has ever been able to turn this type of situation around on a 50-50 basis. It simply has never happened. And if you look at it historically, Ms. Reinhart, maybe you can speak to this, Mr. Holtz-Eakin, really, that the folks who do this successfully are the folks who are more down in the 80-20 range. In fact, of the successful fiscal consolidations in the last several years, there is actually more evidence that 110 percent worth of cuts in spending, with tax reductions, because it leads to what you have just described, which is the opportunity for growth and economic development, that that is the model that we use.

Mr. HOLTZ-EAKIN. I want to concur with that. I mean, that is the, that is the international evidence. Successful growth and consolidation episodes are grounded on keeping taxes down and cutting kinds of spending, government payrolls and transfer programs. Those are the, those are the heart of those things, I completely concur. I just think if you want to go to the American people and say, We are going to cut X dollars, that is not a very compelling story. What you need to do is explain to them, This is important for the opportunities that our children will have. These are the roles we have assigned for our government. We are going to do that, and this is how it adds up.

Mr. MULVANEY. Mr. Podesta.

Mr. PODESTA. Congressman, that might be true, if you are starting from a very high revenue base, but as I noted in my testimony, we are starting from a historically low revenue base. We are at 15 percent of GDP in collections. That hasn't happened since 1950. We have a lot bigger government than we had in 1950. And so if you begin, particularly with the notion that we are going to go further down the revenue stream from there, and begin to think you are going to be able to make that up on the spending side, it is just not realistic.

Under President Reagan, our average spending was 21, 22 percent of GDP. How are we going to get down to that 15 percent rate that is currently the base that we are looking at? Mr. Holtz-Eakin said that the Obama budget gets to 19.6 percent. It does, but on the basis of a bunch of policies which I don't think he supports. So I think that we have got to have some balance here, on mandatories, on discretionary, including defense, as well as with respect to revenue. And I think, if you look at the '93 balanced budget, I think it was about 60-40 cuts versus revenue. So I think we are in similar places, but you have to start from the premise that revenue is at a very low base right now.

Chairman RYAN. Mr. Shuler.

Mr. SHULER. Thank you Mr. Chairman. I would like to thank the Chairman and the Ranking Member, put a great panel together. Here is the ironic thing about it, four non-elected officials could probably sit down and come up with a plan that, that would, the American people would agree with. Unfortunately, and I will say this on both sides, the maturity level is not there from the United States Congress yet. We are still playing politics with the future of the next generation. And at some point in time we are going to have to stop that, because time is of the essence. I look around the room; there are not many moderates on this committee. There is very few of us. I would, I would ask each of you: is there a policy out that is available now for us to review, that you think would be acceptable to the American people? I am not asking, would it be acceptable to the Congress, because we are not there yet.

Mr. HOLTZ-EAKIN. I think you could do a lot worse than to start with what Bowles and Simpson came up with. That commission did a remarkably good job of examining the problem and proposing solutions. And I am deeply disappointed that it has been left on a shelf, and in the dustbin. We really need to take this problem on.

Mr. SHULER. Dr. Reinhart.

Ms. REINHART. I really would like to echo that. It is in the spirit of starting afresh, we are here where we are, and maximizing the options. Bowles-Simpson is a good starting point.

Mr. SHULER. Ms. MacGuineas.

Ms. MACGUINEAS. Bowles-Simpson is a great starting point. I mean, they gave us exactly what we need. They gave us good policies, they found where good political compromises are. It is a commission report, so it gives you all the political cover to get behind it, and say what they are all saying, we don't like every part of it, but it is a good way to start the discussion. You can see what is going on in the Senate, and it is a very productive discussion that is moving forward.

This is what the country needs. It saves $4 trillion over 10 years. I think anything less than that is probably insufficient. And so I wouldn't see why anybody would walk away from this opportunity to start the discussion there.

Mr. SHULER. Mr. Podesta.

Mr. PODESTA. I just want to add one note of caution. I think, actually, there is a lot of agreement, to some extent, on the panel, on the long-run. One note of caution is, to the extent that, it is what Ms. Bass said, to the extent that moving forward requires a complete revision of the tax code, I am for that. We should get rid of a lot of the junk in the tax code and get rates down. I am for that. But the process of producing that is going to be very, very difficult. And we can't wait for that to be done before we begin to tackle these midterm deficit problems, so that we get the debt stabilized.

So if it has to be in two bites, I can live with that. And I think the first bite, I think we also mostly agree on, you have got to go after mandatory, you have got to go after discretionary, and restrain it. I am for putting defense on the table, because I think there is a lot of waste in the defense budget, you could save some money there. And I think, particularly going after these tax expenditures, and getting rid of these loopholes that really don't produce much, economically for the country, you could get a balanced package, and get bipartisan support for it.

Mr. SHULER. Well I certainly hope, and I am very optimistic that we can come to a conclusion. At some point in time, we are going to have to be grown-ups about this. And the next generation will look at us, and wonder if we made the right decision. And if we lose our elections, if all of us lose our elections in 2012 because we made the right decision for the next generation, then that is good for us, and that is good for the American people. Because, 10 years from now, they will say that we will be the best Congress to have ever served.

So I am pleading, I have heard all the back and forth, and unfortunately, most of the, the higher-ranking, up on the top tier, on both sides, continue their political debate and posturing, because it is easy for them to get reelected. And I want to see us start working together across the aisle to make this work for the American people, and for our next generation. I yield back.

Chairman RYAN. Thank you. Mr. Huelskamp.

Mr. HUELSKAMP. Thank you, Mr. Chairman. I appreciate the opportunity to ask a few questions, and as a member of the freshman class, I know there is a lot of finger pointing in this room, but there are some members here that shouldn't be pointed at. I am not saying anybody is, but just to point out, that is the lead-in to one of my questions. And that would be, throughout the last 20 years of Congress, there have been all kinds of balanced budget mechanisms; we are going to solve that.

We can sit here and talk about tough decisions and making those, and I guess the question would be for Mr. Holtz-Eakin, what mechanisms would you say are necessary in order to make a deal secure in future years? Because I would say folks in my district have no confidence, in either the Congress or the President, to actually implement, and to maintain. And I would agree, I think multiple congresses, multiple presidents that haven't balanced that, didn't care to balance it. And so what kind of mechanisms would you suggest are necessary for implementation?

Mr. HOLTZ-EAKIN. I have a couple of observations. The first, and the one that I think is most important, is there are no budgetary mechanisms, PAYGO rules, discretionary spending caps, or anything of that sort, that are a substitute for the Congress having the political will to do this, and agreeing it has to be done. Because any Congress can circumvent rules, and does on a regular basis.

So, rules are not the solution; deciding to solve the problem is the top priority. Having done that, you can then agree on some sort of fiscal goal. I actually don't care deeply which one. Whether it is debt to GDP, spending targets, anything that gives you a way to identify that you are off track; we agreed to do this, but we are off track, you get a warning signal, and gives you a way to say no, Yes, we would like to do that, but the larger priority is our kids and the growth of this economy, we are not going to do that, we have this limit that we can't bust. That is what you need.

And there is no magic to the particular flavors. You have to have an agreement to do it, you have to have identifiers you are not doing it, and you have to have a way to say no.

Mr. HUELSKAMP. Would the rest of the panel agree with that assessment? In short response?

Ms. MACGUINEAS. I would just jump in, because we ran a commission called Peterson-Pew Commission for two years that focused on budget process. And we recommended a set of budgetary targets, so everybody knows what you are trying to get to, triggers, so that if you don't get there they would enforce them and move you back on track, and help keep you on track, and transparency. So the three T's: targets, triggers, and transparency.

But the bottom line is, it won't force anybody to do anything they don't want to do, but it will give you political cover if you do want to do the right thing, and it gives you the way to say no. So I think that framework is really important to help move us in that direction and keep us on track.

Mr. PODESTA. What did produce a balanced budget and a surplus were hard budget caps on the discretionary side, and a real PAYGO that covered both mandatory and revenue. And so, I think, if you go back and look at history, it is worth at least attempting to say, that worked before, why don't we try it again?

Mr. HUELSKAMP. Yeah, and I appreciate that, historically. But we are at such historically high levels, and I don't know how you could implement that. I mean, you lock in trillion dollar deficits, as the President's indicated, sustainable deficits forever. So, Carmen?

Ms. REINHART. Simply put, in this environment, debt targets. Taking into account that Europe has blown Maastricht, but having credible debt targets would be a useful starting point.

Mr. HUELSKAMP. I didn't hear anyone mention though, and I come from state-level, where we have a mandatory balanced budget requirement unlike some other states; no one mentioned a balanced budget amendment, those kind of things, which would be, there would be no legislative way around that, is there opposition to that from any of these members here that believe they don't work, or would not work at the federal level?

Mr. HOLTZ-EAKIN. That is a fiscal rule, and would have the same benefits that, that I mentioned for others. Getting there is going to be awfully hard. We are so far from balanced. And so, I am all for a balanced budget, but I encourage you first to tell me how we are going to get there.

Mr. HUELSKAMP. Well, that, that was the requirement for the panel members today.

Mr. HOLTZ-EAKIN. I have my plan.

Mr. HUELSKAMP. The follow-up question I would have, in reference to that is, and quickly, for each of you, I just have a few seconds left. How many years do we have, and it might have been asked already, counts to five years, I have heard less years, I am going to be listening very closely. How many years do we have, quickly?

Mr. HOLTZ-EAKIN. We don't know; pretend you have none.

Ms. REINHART. Great answer.

Ms. MACGUINEAS. It is a great answer. I am worried, because I have heard the number five around today. And I think that that is too optimistic, chances are that is too optimistic. There are a lot of people who believe that the risk is it could be in the next year or two.

Mr. PODESTA. I think you have this year to lock in a bipartisan agreement to stop the debt from going up.

Mr. HUELSKAMP. All right. I look forward to help from the Senate, and from the administration. Thank you.

Mr. LANKFORD [presiding]. Great. Thank you, Mr. Ryan.

Mr. RYAN OF OHIO. Thank you, Mr. Chairman. We had a meeting yesterday with Mr. Bowles and Senator Simpson, and I have got to say it was very sobering, to just sit with them for an extended period of time, and kind of embody the real gravity of the problem here. I know Mr. Van Hollen has said this, as well as others in the Democratic Caucus, I think, and to Mr. Podesta's point that he just made, I believe that this needs to happen in the next year because if it doesn't, we are going to get into a political year, which we are already actually into the presidential election, already, as the media is portraying it. And, so that whole year will be wasted.

And now we are two years down the line, and all of you are saying, act like it is happening now, which I think we need to do. So just from this perch here, I think we need to drop the rhetoric on both sides and come to an agreement. I think it is important, it has been noted here, President Reagan raised taxes eleven different times, gas, tax, and others. So we are not going to get there from here. We have got to get ourselves in a position where we all agree that the wealthiest, as the Bowles-Simpson proposal has, the wealthiest are going to have to pay more. Because the larger issue for them with investments and business creation, are going to be the credit markets.

And so I think most of them would be willing to pay an extra 30, 40, 50, $100,000 a year, if you are making millions of dollars, if they know that business activity is going to increase. And I think we have got to talk about all of this in that context as well. And also, to make the point that there are tradeoffs here, when we ask the wealthiest to pay a little bit more, what are those programs, what is that money going into? It is going into Pell grants, it is going into job retraining, it is going into research, it is going into things that are going to yield us all a lot of economic activity, as we see China investing hundreds of billions of dollars into clean energy. And I am from a steel district, in Youngstown, Ohio, and Ms. Kaptur is from Toledo, where they are generating solar panel industry.

We are starting to lose the solar panel industry to China. So we are going to reduce our dependence on foreign oil, and then we are going to become dependent on China for our batteries, our solar panels, and everything else. So these investments have to be made, and we have got to ask everybody to participate. And remember that George Herbert Walker Bush lost his election, as Mr. Shuler was just talking about, because he raised taxes because he had to. And that led to Mr. Podesta and crew coming in, and President Clinton, and that leading to enormous economic activity, 20 million new jobs.

One point, and then one question I will let everybody kind of take a bite at, that I wanted to make. The point has been made, and we talked about animal, animal spirits, and my friend Mr. Ribble was talking about psychology, we have a psychological problem. We have a psychological problem in the market because wages have been stagnant for 30 years. This is not psychological; it is a real problem that we have. In the last 10 years we have lost wages. And in Ohio we are going to see tuition increases because of the economic collapse, we are going to see a lot of cuts, we are going to see more burden placed on families. And so, if we don't address the issue of wages, and Paul Krugman's column just talked about this in the last day or so, about the high-growth jobs in the recovery aren't coming. It is the low-growth jobs that are expanding now.

So we have got a real issue, if we are going to continue to have this economic instability and political instability if we don't address the issue of wages in the United States, and health care and other things fit into that.

So, my time is out, Mr. Podesta, if you could just comment on this, and if there is time, we could just work our way down, about the top tax rates. There has been a lot of talk about, those are the people who create jobs. I know you guys, when you came in in '93 made that decision, raised the top tax rate.

Mr. PODESTA. Yes raised the top tax rate, the top two percent.

Mr. RYAN OF OHIO. How did that play out, and how would all of you guys see that playing out as a big diminishment in economic growth?

Mr. PODESTA. Again, you can't make a direct comparison, but GDP growth was twice as strong during Clinton as it was under Bush. Business investment was much stronger under Clinton than it was under Bush, with a 39.6, you know, top tax rate. And so this idea that just by merely cutting the top tax rate we are going to eliminate investment and the economy is going to tank, I think it is just not borne out by history. I think you need a balanced program, one that does exactly what you are suggesting: invests in human capital in science and technology, in the things that power the economy forward. And that is what is going to get wages growing again.

And the only thing I would disagree with you about, Mr. Ryan, is that wages did grow in the 1990s, and they grew substantially in the middle and at the bottom during the 1995 to 2000 period.

Mr. LANKFORD. I wish we had time to get all the other responses. Mr. Young.

Mr. YOUNG. Thanks so much to all of our panelists, I really appreciate you being here today. I am going to focus my question on, if time permits, the role of the U.S. dollar in the world, its current position as the world's reserve currency, how that might be threatened, and the implications thereof.

Before I get into that, though, I would like your thoughts on, what I typically discuss in southern Indiana, as I mix with my constituents, and try and inform them on this issue, get their thoughts and concerns. And one of the things that I try and do is bring it down to the human level. Individual persons and businesses and families, and I thought you might be able to add some additional texture to that overall portrait.

What will things look like if the doomsday scenario, if the debt crisis does in fact play out, if the United States suffers from a Greece, or Japan-like, situation, where either they have to go through a lost decade themselves, or instead, there is a sudden response by the markets as a result of a lack of a credible plan to bring down our debt to GDP ratio.

Some of the things I emphasize are the increase in our interest rates for our treasury instruments, which redounds to an increase in interest rates for all manner of different loans and credit instruments that will impact individuals that I serve. An increase in taxes, perhaps an immediate increase, required to calm the credit markets. An immediate decrease in spending, in a non-deliberative and, frankly inhumane way; it is inhumane, not because our efforts wouldn't be well-intentioned to calm the credit markets, it would be inhumane because we failed to act now, when we could put in place a smooth trajectory, a gradual mechanism to get our debt under control, one that would maintain our social insurance programs for the least fortunate. It would also result, this doomsday scenario, I anticipate, in a decrease in investment, in physical capital, in human capital, all these things that help us enjoy those higher-paying jobs that Mr. Ryan was just lamenting are not as abundant as they once were. Can someone speak to that overall private human impact that we might experience?

Mr. HOLTZ-EAKIN. I am not the place people usually go for humanizing events. But I think you have captured the mechanics of the collapse pretty well. But it will be far more devastating than that, because in that collapse, you will have panic. You think back to 2008, there was palpable panic among individuals, among policymakers, and when people are panicky, and seeing their social services, you know, rendered, you lose a sense of social cohesion. So I believe that there is a lot more at stake here than the economics of it. I believe our social cohesion is, and will be tested, if we fail to address this. And we will, in those moments, also pull back on commitments we have made around the globe. You know, we will bring back the troops from those bases, we will cut off our ground forces in different ways, and we will be more exposed and less of a leader in liberty than we want to be. And I think those are all very damaging things.

Ms. REINHART. I would say, at the very human level, one thing we have to, at some point, start to face, is that the past 10 years were not a good indicator of the next 10. Households have negative equity. That some, many households have negative equity, that is something that has to be dealt with. Households have a debt overhang. Those are issues that were not issues 10 years ago, that we have to think about. I would like to think that, sort of a gradualist approach to debt reduction is more likely. It is, historically, it hasn't worked out that way.

Let me conclude with a commentary on the dollar. One of the things that is actually, actually helping us be more gradualist than we otherwise could be, is that people, notably central banks from all over the world, willing to hold U.S. Treasury securities. But that is also a dangerous proposition. Without gloom and doom, it involves a level of vulnerability that we didn't have 20 years ago.

Mr. PODESTA. Congressman, you know, I think you can go too far with this. I think that, we are not Greece. The United States is not Greece. We have a pretty darn strong set of fundamentals and basics in this country, including the best workforce in the world, the most liquid capital markets, the most innovation, the highest levels of science and technology. But I think what will happen is we will get further away, for many, many people, from the American dream, the ability to really make their children's lives better than theirs, to succeed in their own right. And that is what we have got to be worried about, that is why we have got to take the steps now, I think, to get on a better path.

Mr. YOUNG. Thank you all.

Mr. LANKFORD. Thank you, thank you as well. Ms. Castor.

Ms. CASTOR. Thank you very much, and thanks to the panel for all of your expert advice and involvement in this critical issue. Back home, when folks focus on the debt and deficit, I think they do appreciate that President Obama named a national commission of fiscal responsibility and reform. But if he has seen some of the polling across the country, they, they rank the debt and deficit very high as a problem, and then you say, but they don't want any cuts on anything. So we really need to find something to pull us on that glide path with a comprehensive plan. And the one that seems to get a little traction at home is tax reform, and lowering the rates.

And then you have got to begin this dialogue about, especially, the tax expenditures, I think. Because when you are talking about the tax code, it has got to be holistic. And I want you all to be specific. You can go back to the commission on fiscal responsibility and reform and highlight your favorites, but give us the targets for these tax earmarks, and tax expenditures, especially the ones that have been built up over the years by high-paid lobbyists; people know it, they know it at home.

Give us those, your best targets, so that we can reduce the overall tax rates for the average hardworking American. I would like to hear from each of you on this.

Ms. MACGUINEAS. Well, I will say, I think people are going to want to understand two important things. And one is, do you have a plan? And two, is it fair? And that is going to help people be willing to sacrifice. I think they need to feel that if they make these sacrifices themselves, it will not lead to not fixing the problem, but it will lead to an actual fix.

In terms of tax expenditures, you are putting out a tough question there, but I am sure we will all give you pretty similar answers. There are two big ones that need to be reformed: the health care exclusion, the home mortgage interest deduction. That is the bottom line, every policy analyst on both sides of the aisle knows that these are not good policies, and that is, the core of really thinking about tax reform. And people can choose to go after them and try to demagogue them, or people can talk about the benefits of a better tax system that is not regressive, that has more oversight, that leads to lower rates, and is part of a fiscal fix. And these tax breaks and others have to be reformed.

Mr. PODESTA. Well, Ms. Castor, I think they fall into two big categories. Maya mentioned one, which is on the personal income tax side: the exclusion and home interest deductions. And, particularly on second homes, you could go after that fairly easily, I think. But I think there is a lot in the code on the business side that would strike people back home as, what I would describe as, you know, tax exclusions that they think of, tax expenditures that are really narrow, they are focused on a very small number of businesses.

I guess my favorite still remains the tax breaks to the oil and gas industry. The top five oil companies have made $931 billion in profits in the last 10 years. Do they really need additional incentives to continue to produce what they are producing in their business? I don't think so. And it is a waste of money, and I think people are getting gouged at the pump right now, and they would understand why that level of support to an industry that doesn't need it could be withdrawn, in a time when we have high deficits.

Ms. REINHART. I would like to point out that, realistically, I think there is broad agreement that we need higher savings and that interest deduction on housing is something that should go. But let us look at the housing market. The housing market is in an all-time, historic slump. The timing for that is probably problematic. So it really goes back to my two-thirds and one-third. I do really think that one has to go back to, I would like to be told by the doctor that I can lose weight and eat just as much. But I really do think that the expenditures side, particularly in light of demographics, is unavoidable.

Mr. HOLTZ-EAKIN. Briefly, I think we have to educate the American people on the reality of the tax code. For the majority of Americans, the biggest tax they pay is the payroll tax. So if you talk about tax reform to them, there is nothing to do. A minority of Americans are now paying the income tax, and it needs to be radically reformed to reflect the reality.

Go to the President's panel from a couple years ago, the growth investment tax plan, adopt it tomorrow. Way better than anything we have got.

Ms. CASTOR. I am not even familiar with what that is.

Mr. HOLTZ-EAKIN. I would encourage you to become familiar. Mortgage interest, the health exclusion; those have been on the table for years. Congress has never touched them. You should go do exactly what Bowles-Simpson did with the corporate tax. You should go to a territorial system with a low rate, because, in the end it is the American worker who is paying that tax. Companies don't pay taxes, people do. And the workers are getting hurt by the uncompetitiveness.

Ms. CASTOR. Thank you.

Mr. LANKFORD. Thank you. Mr. Flores.

Mr. FLORES. Thank you, Mr. Chairman. And I want to thank the panel for joining us today. And except for the rock-throwing back and forth, it has been a fairly-informed panel, and I apologize, I am sorry that you had to put up with the rock-throwing. I am not going to throw any rocks. I am going to ask a couple of questions for you. We have got a couple of alternatives out there. We have got this, that is supposed to be winning the future. You have got the Bowles-Simpson Commission that I think did some really good work. Looking at the Bowles-Simpson plan, and I would like each of you to limit your answers to about 15 or 20 seconds, what would you do to make the Bowles-Simpson plan better? We all said that is a good place to start. What would you do to make it better? So let us start on the right with Mr. Podesta.

Mr. PODESTA. Well, I think that, I noted earlier, that we think that Social Security reform could be tackled, but I think the way they tackled it is wrong. And I think there is a way to protect people at the bottom in Social Security and still get that 75 years of actuarial integrity and that is where I would probably start.

Mr. FLORES. Okay.

Ms. MACGUINEAS. I think it is a terrific plan, I think the main thing that needs to be filled out is how you would live within the health care budget that they proposed. So in the decade when you would start controlling health care cost to GDP plus one, we need to figure out structures that are going to fill that in. And I actually think, on Social Security, we use too much of the revenue to funnel into Social Security, and I would use that more on investments, and bring benefits down for the well-off in Social Security a little bit more aggressively.

Mr. FLORES. Okay. So greater means-testing. Ms. Reinhart?

Ms. REINHART. I think we need to be a little more aggressive on Social Security benefits.

Mr. FLORES. Okay. Mr. Holtz-Eakin?

Mr. HOLTZ-EAKIN. I am going to echo those, I think the biggest hole though is, we really took a pass, a serious pass on health programs. And those are the problem going forward, so you have to take those on.

Mr. FLORES. You talked about health programs, but it seems to me like Medicare is the biggest issue, that is the biggest gaping wound that we have in our future financial security.

Mr. HOLTZ-EAKIN. I believe that if you look at Medicare, Medicaid, and the Affordable Care Act collectively they are the threat.

Mr. FLORES. Okay, thank you. Looks like I have some more time, so I am going to ask you another question. This hasn't been brought up. One of the things that I have seen, I was a CEO of a small company, and one of the things that I felt, and that people are feeling today, is the impact of regulation on the economy. We haven't touched that, and that is not going to be in the budget, but I think it is an important component of what is restraining the economy. And so I would like each of you just, again, 10, 15 seconds, do you think that our regulatory zeal today is hurting our economic potential? Let us start on the left.

Mr. HOLTZ-EAKIN. Absolutely. A chief indicator of regulatory activity is federal register pages, and last year we set a record, exceeding even when the Bush Administration set up the Department of Homeland Security, I never thought we would beat that. And that is before we see the implementation of the Affordable Care Act, before we see the Dodd-Frank common line and before the EPA rolls out its boilers and other foremeasure rules. So we are in the midst of a massive regulatory push.

Mr. FLORES. That is a terrifying metric. Ms. Reinhart.

Ms. REINHART. I alluded to this in my earlier remarks; I think we are going to see even more heavy-handed regulation. It won't be called financial repression, it will come under the guise of prudential regulation, but I think we will, and pension funds will be importantly affected.

Mr. FLORES. But is it or is it not hurting us, in terms of economic potential?

Ms. REINHART. The historic experience has been that financial repression is not conducive to growth.

Mr. FLORES. Okay. Ms. MacGuineas.

Ms. MACGUINEAS. Yes, I certainly agree with that point, and I think we need to do everything we can to enhance competitiveness, both by lowering the corporate tax rate in a revenue-neutral way, and dealing with regulations. And I think that principle, that businesses don't pay taxes, people pay taxes is very important. I also, however, have a real belief that the income and equality problems that we have are real. And so, while I would try to bring down burdens on businesses, I am perfectly comfortable with a more progressive tax code that reflects people who are doing well also contributing at the personal level, and letting businesses thrive and be an engine of growth.

Mr. FLORES. Okay. So, by having a more moderate regulatory scheme, I am assuming, partially.

Ms. MACGUINEAS. That is one of the necessary components for increasing competitiveness.

Mr. FLORES. Right, good. Mr. Podesta.

Mr. PODESTA. I think one, I think one of the history lessons of the past couple of years is that, if you take the argument too far, regulatory laxity produces really disastrous results. And the failure to regulate the financial sector led to a meltdown that is being felt today in every community across America. So you have got to find the right balance. I think that the new executive order that the President signed at the beginning of the year to try to find that right balance, get rid of regulations that are not producing the results that they are seeking to achieve, while you push forward with smart regulation is where the country needs to be.

Mr. FLORES. One last question, as I am about to run out of time. Ms. Reinhart, I really appreciate your work that you have done to talk about the impact on GDP versus debt levels. My question is this; inside the President's budget this year, it has some GDP growth assumptions based on what I consider to be a fairly high debt level. It doesn't even talk about actuarial unfunded liabilities. What do you think about the economic assumptions of, basically, four percent GDP growth in this?

Ms. REINHART. In one word, improbable.

Mr. FLORES. Okay.

Mr. LANKFORD. One word is perfect for the timing.

Mr. FLORES. Thank you.

Mr. LANKFORD. Mrs. Moore.

Ms. MOORE. Thank you so much, Mr. Chairman. And thank you very much for appearing today. I am really proud to see women as experts in economics, and so I really appreciate your being here. Everything has been asked, except that everybody hasn't asked it. So forgive me if I am asking some of the same kinds of questions. I want to get right into the discussion of some of the Bowles-Simpson's recommendations, and to really flesh out this whole thing about entitlements. You know, it has become such a buzz word; we have got to reform entitlements.

In my understanding, I am glad there was already a discussion about some of the tax expenditures. But farm subsidies, and as you pointed out, Mr. Holtz-Eakin, the prescription drug program where we did not ask pharmaceutical companies, at all, to lower their prices, or to negotiate with them, as being one of the problems. And you also pointed out, Mr. Holtz-Eakin, that the problem was the cost curve in health care, period, at least I thought, not being curved. Not so much a problem with, as I think Mr. Podesta pointed out, that when Medicare and Medicaid came into effect, just like three-tenths of one percent of federal spending on health care. But this unsustainable growth.

So I want you all to comment on the problem with entitlements and mandatory spending as being something other than Social Security. I don't think that that is the driver of the debt, I think it is these mortgage interest deduction tax expenditures, which are mandatory spending, farm subsidies, is that correct? People are using this entitlement thing, and people are interpreting it as Social Security, and that is not correct, am I correct about that?

Mr. HOLTZ-EAKIN. It is not just Social Security, but Social Security is certainly part of the problem. Running a cash flow deficit right now and those cash flow deficits will rise with time, and the program is on track to deliver to the next generation, 22 percent across the board cuts, that is unconscionable.

Ms. MOORE. Okay, so let others answer, please.

Ms. MACGUINEAS. Well, entitlements are all programs of mandatory spending that don't go through a normal appropriations authorization process.

Ms. MOORE. Like the mortgage interest deduction, for something, it goes to Oprah.

Ms. MACGUINEAS. That is right, I would completely agree, that tax expenditures are very much like entitlements in their automatic nature, and that we should be budgeting for all.

Ms. MOORE. So when we talk about it, I am just saying, we need to not just hone in and say Social Security.

Ms. MACGUINEAS. No, I think we hone in on the ones that are the biggest drivers of growth, though, which are the ones that are related to aging and health care. So Social Security, Medicare, and Medicaid are the most problematic, but the way we budget, we need to look at all of these things on a regular basis.

Ms. MOORE. Let me get Mr. Podesta to answer this question, and then let me move on.

Mr. PODESTA. Well, I think you are exactly right, Congresswoman, that the mandatory spending is broader, I think, with respect to health care. That is a challenge of delivering better health care at a lower cost across the board, not just in the federal programs. That is where we really need to, I think, spend our time and attention, which will have impact on the federal programs, I think as one of the previous members pointed out, the inflation in the federal programs is actually lower than it is on the private sector. So we need to produce that result.

Ms. MOORE. I didn't understand, for example, why Mr. Holtz-Eakin, said we ought to get rid of the American Care Act, but then he agreed we need to slow the growth in the private health care. I just didn't understand how that could be done. And Mr. Podesta, I want you to comment on his testimony.

Mr. PODESTA. Well Doug and I have debated this for a long time, I think that the drivers in the bill will restrain the growth of health care spending, and I think, if you repeal it, as the CBO indicated, you are going to have both a negative effect on the overall federal budget deficit, and a negative effect on health care spending.

Ms. MOORE. Thank you, Mr. Podesta. I do have 50 seconds left. I turned on the news today, and thank God they weren't talking about Charlie Sheen or Lindsay Lohan but they mentioned that there were, you know, 199 new billionaires during this whole worldwide recession. And so I guess I wanted to ask you, I didn't vote for the extension of the Bush-era tax cuts, even the ones that benefit the lower-income people, because I see that they benefit wealthy people six times as much as they do higher-income people. How does inequality fit in with some of our deficit problems? There won't be people to consume, for example. Mr. Podesta.

Mr. PODESTA. Inequality; I think that if judged by history, when we have a thriving middle class, when we have people at the bottom who are getting into the middle class, that produces a stronger economy overall, stronger receipts, it actually has an effect on the budget, so I think we very much should be concerned about it.

Ms. MOORE. Thank you so much. This is a great panel. Thank you Mr. Chair.

Mr. PODESTA. Thank you.

Mr. LANKFORD. Thank you. Mr. Stutzman.

Mr. STUTZMAN. Thank you, Mr. Chairman, and thank you to the panel for being here today; I really enjoyed the conversation today. The title of the hearing today is Lifting the Crushing Burden of Debt and I guess what I have heard a lot of today is, we need to control spending, we need to possibly raise revenue through tax increases, and I want to start with Mr. Podesta. In your testimony, we are all talking just recently, here in the House, about where do we start cutting debt? And on page six of your testimony, you mention the shock of asset-constrained government spending in the immediate would have an undeniable effect on our wider economy. Our Moody's chief economist says that it could lead to a loss of about 700,000 jobs, and then Chairman Bernanke agrees that it could result in a couple of hundred thousand jobs, and then you mention that there is wide consensus on the general impact.

Mr. PODESTA. Except for Mr. Holtz-Eakin.

Mr. STUTZMAN. Well this is what I want to ask, is what kind of job loss are we looking at?

Mr. PODESTA. Well I think that virtually everybody who has taken a look at this, Doug is an exception, has said that there will be some loss of jobs, and there is a range of forecasts there. And I think that the general direction is clear, and that is why I am not saying that we shouldn't restrain non-defense discretionary spending. We call for specific cuts to do so. But the deep cuts that are included in HR 1, I think, would have a negative effect in the very near term, and my other beef is that you don't go after any of the other components. You are narrowly focused on 12 percent of the budget. So those things will have an impact in the short term.

Mr. STUTZMAN. Are these primarily public or private jobs?

Mr. PODESTA. I think they are on both sides of the ledger, mostly in the private sector.

Mr. STUTZMAN. This is what concerns me, and I give the Clinton administration a lot of credit for the way that they handled the situation throughout the 90s. There were tax increases right at the beginning, there were tax cuts at the end, and I believe that Republicans, when they were in charge were in the early part of this last decade, failed, and that there should have been better control in spending. And I think that we need to go into this very disciplined, and my concern is when we start—we are only talking about $6 to $60 billion in cuts right now, and when we go out and we hear the rhetoric saying, Well we are going to lose up to 700,000 jobs, that puts fear in the American people. That puts fear in Congress. We don't want to do that. And if we can't even cut $6 to $60 billion right now in the near term, I don't see the political will long-term, ever. And I guess that is my concern, at some point this type of rhetoric needs to stop, because I think the American economy is more resilient than this.

Mr. PODESTA. Well so far, it has been partly because of the deep financial shock from the recession, it has been less resilient than I think a lot of people would have predicted. But it is coming back, the private sector is producing jobs, almost a million jobs produced last year, we need to make sure that keeps going, I think. That is key, I think, to create the circumstances under which you actually can get the deficit down because it takes money out of the unemployment insurance system, et cetera. And it will increase revenues.

Mr. STUTZMAN. Okay, really quick, I just want to ask this question of the entire panel, and answer is as long as we have time. My question is what is a predictable and sustained rate of debt to GDP?

Ms. MACGUINEAS. Well we have recommended that it be brought back down to 60 percent of GDP within a decade, but that it needs to go back to historical levels of below 40 percent to maintain fiscal flexibility.

Ms. REINHART. The median debt-to-GDP in the advanced economies has actually been 36 percent post-World War II. We are a long range from there. I think 60 is a good starting point.

Mr. HOLTZ-EAKIN. I concur.

Mr. STUTZMAN. Okay. I think that again, we need to start looking at our, we need to control spending first before we even discuss, and I like what Erskine Bowles and Simpson did propose, I think that is a great starting point in the dialogue, but until we start controlling our own spending, and I think this sort of fear put into not only Congress.

Ms. MACGUINEAS. One quick question which is, while I think there is some problems with HR 1, that it is probably too large, too small a part of the budget, and a little bit too early, we are starting to control spending, and that is going to have large positive fiscal effects, the fact that we are talking about cuts. And even though it will have some negative effect in the short run, what these studies don't show is that it will have positive gains over a longer period, to make these fiscal improvements. And that is what we need to emphasize.

Mr. STUTZMAN. Thank you.

Mr. LANKFORD. Thank you. The gentlelady from Ohio is recognized.

Ms. KAPTUR. Thank you, Mr. Chairman. Welcome to the panelists, I am sorry I had two, actually three concurrent hearings, so I came late and I have read your testimonies. The housing sector's continued demise, with 26.5 percent of the American people being underwater on their mortgages and in my district, 37.5, continues to be a serious damper on recovery. Ohio, Wisconsin, where we see people mobilizing in the state capitals, are in deep trouble because their property taxes have not been paid in at the normal rate, and with the large numbers of foreclosures, school systems and state governments just simply can't keep up. And therefore the solution I see them proposing out there, at least those governors is, Well, get rid of teachers, get rid of police, rather than solve the fundamental problem, which is recovery in the housing sector.

Now a few Wall Street banks took us down this very dangerous road, and they threw our economy into a very deep ditch, and what I see happening is that the six big ones that remain, that now control two-thirds of the banking system of this country; Citigroup, J.P. Morgan Chase, Wells Fargo, Goldman Sachs, Morgan Stanley, and Bank of America are making extraordinary profits, $55 billion just last year for those six. This year, Bank of America is going to get a $666 million refund, and those six institutions have paid a net effective tax rate of 11 percent when businesses in my district are paying a 35 percent rate. I am thinking, what is fair about this? Wait a minute; we are not addressing the housing problem. Not one prosecution, not one. And the housing sector continues to deteriorate, and they are running away with the money, and they control two-thirds of the banking system in this country. I call that a great crime. Now I notice a number of you actually have ties to Wall Street, and I am going to place this in the record. Mr. Holtz-Eakin, the Board of Directors for American Action Forum, does it still include Robert Steele?

He is gone. Okay. He had been a former executive of Goldman Sachs when he served on your board. You personally were a senior staff economist for President Bush at the Council of Economic Advisers, am I correct on that?

Mr. HOLTZ-EAKIN. That is correct.

Ms. KAPTUR. Correct and Mr. Bush never submitted one single balanced budget to this Congress, because I served during those years. I am not saying you don't have a lot to contribute to the conversation, but let us look at the record. Now Ms. Reinhart, you are a fellow at the Peterson Institute, and you had been the chief economist, am I correct? For the investment bank of Bear Stearns back in the 1980s. And the Peterson Institute receives major contributions from Mr. Peterson, and he had been the former chairman and CEO of Lehman Brothers. Am I correct in that? Is my information correct?

And he co-founded the private equity firm of Blackstone Group. I am just saying, the influences on Congress, where we get our opinion from, we have many new members. It is important to know who is giving us information and who isn't. Ms. MacGuineas, you are with the Committee for a Responsible Federal Budget.

Mr. Peterson also contributes money to the Committee for the Responsible Federal Budget, am I right on that, Ms. MacGuineas? Yes, I think that is really important to place on the record. And Mr. Podesta, you were the chief of staff to the only president that ever gave us a balanced budget in my whole career here, so it seems to me you have got something to contribute to the conversation here. But my fundamental question is, in the housing sector, we lack a solution as a country, and that is pulling us down coast to coast. You really haven't addressed it in your testimonies to any great extent. The fact that it is missing is of great concern for me. Should it be?

Ms. REINHART. It certainly should. One of the things I have been saying for many years now, since the crisis began, is that we should move forward to write down bad loans. The problem of having mortgages with negative equity is a serious one, and it is time to start having financial institutions price those loans closer to market. Until we do get rid of that debt overhang and those zombie loans, they were called zombie loans when they were in Japan, we will have a very weak housing market.

Ms. KAPTUR. You know, by the way, that the majority of those asset-backed securities, the mortgage-backed securities, were traded through Cancun? I don't know if people on the committee know that. Any comments about why that might have been done? You know it is a tax haven? Goldman Sachs and the companies that did that made a whole lot of money. Nobody has done a single thing about it. Thank you, Mr. Chairman.

Mr. LANKFORD. The gentleman from Georgia, Mr. Woodall, is recognized.

Mr. WOODALL. Thank you, Mr. Chairman. I want to inherently I associate myself with my friends on the left because I think they bring a lot of value. I want to disassociate myself with Ms. Kaptur's comments and tell you how much I appreciate you being here, in particular Mr. Podesta and Ms. MacGuineas. You all invested time in us at the bipartisan freshman retreat, and I remember those sessions well. We had a particular amount of fun on the chief of staff session; you all gave us a lot of good stories, and I don't know where we go as freshman if folks aren't willing to come and invest in us like this. I tell folks regularly that the best part of my job is really smart people who want to come by and make me smarter. And I certainly appreciate the willingness to engage and do that as the last fellow who generally gets to ask questions here in the Ws, folks are often anxious to depart, but I just had a couple of things on my mind.

Everybody talks a lot about tax expenditures. I wish there were more of my colleagues left, I actually have the only bill in Congress that eliminates all corporate tax expenditures. I am a big believer that those are spending measures. It is the Fair Tax Bill, it actually abolishes the corporate tax rate altogether, because I believe, as you all have said, that only consumers pay taxes, whether it is the shareholders or whether it is the employees or whether it is the purchaser, it is only us at the end of the day that pay those taxes, and I would have welcomed more support for going after those tax expenditures, but let us talk about the regulation side again, and we started down that with Mr. Flores a little bit earlier.

Do you think that is coming? Because I saw an editorial in the Wall Street Journal, I think it was in January, that had a giant spike in the cost of compliance with reg.s back in '92, as the Clean Air Act was coming online, and then it dropped down and was fairly level throughout the '90s and the early part of this decade, but the last four years, we had spiked back up to those 2000, or that 1992 level and even gone 25 percent higher in 2010. If we can agree that tax expenditures are just the same as spending and ought to have the same amount of oversight on them, can we also say that about regulation, that we ought to consider each and every reg. with the same critical process that we consider each spending bill and each tax bill?

Mr. HOLTZ-EAKIN. I believe so, yes. I mean, these are the same as taxes. Just as you remit tax payments, you have compliance costs, you have to spend money, and in the same way that taxes can cause a business not to hire one more person, not to make the last investment, regulation can have the exactly the same influence in economic activity. And so I am concerned about the pace at which new regulations are being rolled out for two reasons. One, the overall economic burden might not be matched by benefits. I mean, these things aren't done gratuitously. There is a reason regulations show up. But I am worried that we have gone too far. And the second is that rapid rule-making is generally bad rule-making. The Affordable Care Act and the Dodd-Frank Bill both share a characteristic of what I think are unrealistic rule-making deadlines that will produce bad regulation in the end.

Mr. WOODALL. We talked a little bit about income inequality, that is something that concerns me as well, though it concerns me more that if it comes from a place of productivity, inequality. And I actually think of what we are doing on the tax code and the reg. side of things as creating productivity inequality among American citizens. It doesn't trouble me if we have income inequality if it is in line with what one produces and contributes. Can anybody point me to any studies, information where I can educate myself about whether we have seen a change in productivity inequality as we have seen a change of income inequality?

Mr. PODESTA. Mr. Woodall, I would be happy to try to get you something for the record. I think the one thing that is characteristic really, of the recent period of economic history is that productivity gains in the economy have not been shared by the entire workforce of the enterprises that are making those productivity gains, the way they had been in previous decades and particularly in the post-World War II period. So we have a lot of productivity in the economy, most of the revenue from that, most of the gains from that, have gone to the top, and that has been a change and that has led to the deep income inequality that was commented on earlier.

Mr. WOODALL. And let me use my last 10 seconds to say, as much as I value the Gingrich-Clinton years, and I do, I view those as very productive years, I look back at what we did with Medicare reform, where we are still kicking the doc fix and the SGR down the road, what are we now? Twelve years later, 15 years later, and so as scary as it is to do things today, to do things now, to do things immediately, I have seen what happens when we put something on the list for three years from now, and I appreciate folks being willing to do things today. Thank you all for being here.

Mr. LANKFORD. Thank you. The Hoosier from Indiana, Mr. Rokita.

Mr. ROKITA. Thank you, Mr. Chair. Only place where Hoosiers are from, really. Unless I am missing some of my constituents I need to get to. Thank you for your leadership, Mr. Chair. I want to put some things on the record, and for nothing else, I appreciate today's discussion. I appreciate you all coming, I appreciate what Mr. Ryan from Ohio said, I appreciate even what Mr. Pascrell said earlier, and I also enjoy Congresswoman Kaptur. We have been able to have some excellent conversations in the short time that we have known each other, maybe with today's issue aside. But even with today, I know that what you say comes from a genuine concern.

What I saw that was disingenuous, Mr. Chairman, on this committee today are comments from Ms. Schwartz. And they are almost so silly that I risk using time to refute them, but I think the record deserves it. To say that what we are dealing with here in terms of a $14 trillion debt, in terms of $100 trillion in promises made to future generations, is somehow the fault of the last administration, that is her words, is ridiculous. And then to further compound that problem by saying the only thing that this current Congress has done is propose $61 billion in cuts, really puts salt in the wounds. Her party can't even get to $61 billion in cuts, and I agree with her that it is only 12 percent, that discretionary spending is only 12 percent of the budget. Can't even get there. And that is why Mr. Ryan's comments, Ms. Kaptur's, and Mr. Pascrell's, even, are so important. We need to get there. To make sure we have a full picture for the record, Mr. Podesta, I just want to ask you a few direct questions before I get onto some other ones, and hope they have direct answers. And I hope you would agree with them.

The years that President Clinton, and I appreciate his leadership, because he led on the budget—in the years that we had a balanced budget, which party controlled Congress in each one of those years?

Mr. PODESTA. In 1998, 1999, 2000, and I would probably put 2001 in that as well, the Republican Party led the Congress.

Mr. ROKITA. That is what I wanted to know. I will get to some other questions here now, reclaiming my time. And under the Constitution, is it not the Congress' job to control the purse strings? To create and pass a budget is one of our core constitutional duties.

Mr. PODESTA. I would hope so.

Mr. ROKITA. Okay, right. And wasn't Ms. Schwartz's party in the last Congress that failed to do that?

Mr. PODESTA. Well, Ms. Schwartz's party passed a continuing resolution that funded the government.

Mr. ROKITA. That is what I thought, okay. Just want to make sure we have that full picture there. As much as I appreciate Mr. Clinton's leadership, it takes two to tango, especially when it comes to a budget, in this case, a Congress that is also willing to lead. And that is what we need now, and that is what we are trying to do now.

Mr. PODESTA. You know what? I agree with you.

Mr. ROKITA. Thank you. Can you put the cartoon slide up, if you can, please? The one with the ship and the submarine? Let me get to that question. As they are putting that up, let us talk about the way in which the growing U.S. debt could impact America's status as a world power, as well as its freedom to act. According to the CBO's long-term budget projections, U.S. interest payments on the debt will begin to exceed our yearly defense spending in 2022, and then double in 2037. Can a country that borrows this much maintain its economic and military power and diplomatic leverage over the long run?

Mr. HOLTZ-EAKIN. I clearly expressed my concern about that. I don't believe so.

Mr. ROKITA. Okay, thank you. Ms. Reinhart.

Ms. REINHART. All we have to do is look at the loss of the British Empire.

Mr. ROKITA. Okay, thank you. Maya.

Ms. MACGUINEAS. Our influence in the world is clearly already on the decline, and I will just quote a friend of mine, former member of Congress Tanner, who always says, We have an agreement that we would protect Taiwan. If China were to attack, the problem is we would have to go and borrow the money from China. That is just not the position we want to be in.

Mr. ROKITA. I laugh so I don't cry. John?

Mr. PODESTA. I agree.

Mr. ROKITA. Final thing, just to put all your comments in context, I just want to ask you a basic one real quick. Art Laffer's curve, does it have validity or not when it comes to the tax issues you brought up?

Mr. HOLTZ-EAKIN. It is correct in principle, but we have never been over the top of it.

Ms. REINHART. I concur.

Ms. MACGUINEAS. It is not relevant to where we are in the tax rates right now.

Mr. ROKITA. John?

Mr. PODESTA. Well, I again reference back to the last couple decades of history, and I think it would probably be a bad place to begin this conversation.

Mr. ROKITA. Thank you all very much. I yield back.

Mr. LANKFORD. Thank you, and I yield to myself the five minutes that remain here as the final person doing the questioning. Yesterday we had the privilege of having a joint session of Congress and the prime minister of Australia; she came and spoke to Congress and to all of us as American people. And one of the interesting things she kept coming back to was this clear statement, that she believed as a child watching us land on the moon, Those are Americans and they can do anything. And there is this sense that is rising up that I sense from Americans, saying we have got to take on the big, difficult thing of our time, and that is our debt. And it has been very interesting to be able to hear your comments on it, and to especially hear you say, this is not something that can be done five years from now. This is something that has to be done right now. So I appreciate your comments and all of your work, and for you coming here and spending so much time with us and letting us get a chance to ask you some random questions with it.

Knowing that, we are fully aware you can't just shut the government down for a couple years and say we are not going to spend money on anything. This conversation that is happening between investing while we are also trying to cut the debt. We understand we have to do infrastructure projects; there are things that still need to be able to continue on. What would you recommend as a balance, or as a thought that you have clearly between this balance between investing, and also we have got to get aggressive in cutting the debt.

Mr. HOLTZ-EAKIN. I think the key is to recognize that the budget at the moment is structured so that the legacy programs of our past, the Medicare's, the Medicaid's, the Social Securities, are going to crush our ability to invest in the future. They are literally just pushing out any ability to do discretionary spending. And if you are going to let your past crush your future, you are going nowhere as a nation. So you have got to fix that.

Mr. LANKFORD. Any comments from anyone on that?

Mr. PODESTA. Yes, Congressman. You know, this is where the rubber hits the road. Because this is where the tough choices need to get made. And I think that we know what produces productivity in the economy, we have seen it in the past, investments in education, and building human capital in giving people the skills they need to succeed in science and technology, those produce strong results. So we have to find a way to pay for those. And the issue around health care and particularly Social Security, I come back to what I said in my prepared statement, which is in the early 1960s, nearly 30 percent of elderly Americans lived in poverty. Today less than 10 percent do. So we can't abandon that commitment; we have got to find a way to produce health care in a way that is going to produce good results at a lower cost.

Mr. LANKFORD. Right. And I don't hear a lot of people trying to abandon that commitment. The question becomes how do we do that? Because currently we are trying to make life in this generation easier by making it harder on the next generation, and it is progressively getting closer and closer to this generation making it much tougher, based on putting the hard decisions off, putting it off, putting it off.

Mr. PODESTA. I agree with that.

Mr. LANKFORD. Let me bring up just some process things to you as well, just for perspective. Since 1921, the President has submitted a budget to Congress, which I understand since 1922 has been dead on arrival each year when it comes, but just this perpetual process of the President setting out the wish list, both parties, and then Congress trying to work through the process on that. Is there a benefit to setting some harder caps on it a year before, that Congress is able to send to the President, You can submit a budget no larger than, please work with your agencies and submit a budget that fits under this criteria, and that allows the Executive Branch and the Legislative Branch then that next year to work on a budget, knowing that we are all dealing with the same numbers.

Ms. MACGUINEAS. I would say that right now, given where we are in our budget challenges, what we should really be thinking about is multi-year budgeting. And we need to have a fiscal path that would bring us to stabilizing the debt at a sustainable level and then below over more time, and I think the way to do that is multi-year budgeting, and I think you have to put hard caps and triggers in the budget. Again, budget process will never fix this problem alone, but it needs to be there to strengthen whatever policy deals people came up with so we can stay on track over the multi years it will take to get us back to a place of fiscal health.

Mr. LANKFORD. Thank you. Other comments on that?

Mr. PODESTA. I agree with that, I just had one note, which is that in the 1980s, after Gramm-Rudman-Hollings passed, the caps were set at an unrealistically low level, and therefore they were continuously blown through and Congress set them aside. I think they have to be realistic, but I think having hard caps that can be enforced is really the trajectory on the discretionary side, and as I said earlier, I think you have to have the same kind of discipline through a strong PAYGO mechanism on mandatory and the revenue side.

Mr. LANKFORD. Terrific. Thank you all for coming and for being a part of this, I really appreciate it. You worked right through lunch, I am sure you had a long day of preparing yesterday and then a trip to be able to get over here and come through security and everything that you did today, so I appreciate very much your time and for being here and investing in the future of our country. With that this budget hearing is adjourned.

[Additional submission from Ms. Kaptur follows:]

SUBMISSION OF HON. MARCY KAPTUR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

BIOGRAPHIES AND REPORTED SOURCES OF PRIVATE FUNDING OF WITNESSES

Douglas J. "Doug" Holtz-Eakin—President of the American Action Forum

In early 2010, Mr. Holtz-Eakin became president of the conservative American Action Forum.

According to the New York Times, the Board of Directors for the American Action Forum includes Robert K. Steel, a former executive of Wachovia and Goldman Sachs. A major contributor is believed to be Kenneth G. Langone, a founder of Home Depot and a former director of the New York Stock Exchange.

1. Appointed to the Financial Crisis Inquiry Commission in 2009
2. Chief Economic Policy Adviser to U.S. Senator John McCain's 2008 presidential campaign
3. Senior Staff Economist for President George H. Bush's Council on Economic Advisors.
4. Director of the Congressional Budget Office, from 2003—2005
5. Visiting Fellow at the Peterson Institute, from 2007—2008
6. Former academic appointments at Princeton and Columbia Universities. He later received tenure at Syracuse University.

Carmen M. Reinhart, Ph.D.—Fellow at the Peterson Institute for International Economics

Reinhart is also a researcher at the National Bureau of Economic Research and the Centre for Economic Policy Research and a member of the Congressional Budget Office Panel of Economic Advisers and Council on Foreign Relations.

The Peterson's Institute receives major contributions from Peter G. Peterson and his wife. Mr. Peterson is a former Chairman and CEO of Lehman Brothers, and he co-founded the private equity firm the Blackstone Group. In 2009, he reportedly gave the Peterson Institute $8.5 million.

1. Formerly a professor of economics at the University of Maryland
2. Chief Economist and Vice President at the investment bank Bear Stearns in the 1980s.
3. Also spent several years at the International Monetary Fund.

Maya MacGuineas—President of the Committee for Responsible Federal Budget

She has served as the group's President since 2003.

Ms. MacGuineas' organization reportedly receives major funding from billionaire Pete Peterson. (Peterson, who also provided contributions to the Peterson Institute for International Economics, was Chairman and CEO of Bell & Howell, from 1963 to 1971. From 1973 to 1984, he was Chairman and CEO of Lehman Brothers. In 1985 he co-founded the private equity firm, the Blackstone Group. He also served as Secretary of Commerce under Nixon.)

1. Served on The Washington Post editorial board, in the Spring of 2009, covering economic and fiscal policy, and writing extensively on the health care reform debate
2. Social Security Adviser to the McCain Presidential Campaign. (She claims to be nonpartisan)
3. Worked at the Brookings Institution and the Concord Coalition
4. Worked on Wall Street (Firms Unknown)

John Podesta—President and CEO of the Center for American Progress

Major individual donors include to the Center for American Progress include Peter Lewis (Ohio based Chairman of Progressive Insurance), Steve Bing (New York Real Estate Developer and liberal philanthropist), George Soros, and Herbert M. Sandler.

1. Co-chairman of the Obama-Biden Transition Project, and visiting Professor of Law at Georgetown University

2. Assistant to the President, Deputy Chief of Staff, and White House Chief of Staff during the Clinton Administration

3. In 1988, Podesta founded with his brother, Tony, Podesta Associates, Inc., a Washington, D.C., "government relations and public affairs" lobbying firm. Now known as the Podesta Group, the firm "has been retained by some of the biggest corporations in the country, including Wal-Mart, BP and Lockheed Martin."

4. Podesta held positions on Capitol Hill, including Counselor to Democratic Leader Senator Thomas Daschle (1995—1996); Chief Counsel for the Senate Agriculture Committee (1987—1988); Chief Minority Counsel for the Senate Judiciary Subcommittees on Patents, Copyrights, and Trademarks; Security and Terrorism; and Regulatory Reform; and Counsel on the Majority Staff of the Senate Judiciary Committee (1979—1981).

5. Podesta worked as a trial attorney for the Department of Justice's Honors Program in the Land and Natural Resources Division (1976—1977), and as a Special Assistant to the Director of ACTION, the Federal volunteer agency (1978—1979).

[Questions for the record and their responses follow:]

QUESTIONS FOR THE RECORD SUBMITTED BY HON. MICHAEL M. HONDA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. Reinhart: Economists contend that mandatory spending will drive the impending fiscal crisis. Because of this, would you agree that it is impossible to bring our debt and deficit crisis in line through a plan that solely cuts non-defense discretionary spending?*

Ms. MacGuiness: You testified today about the psychological aspects of the debt crisis. As I understand it, you are suggesting that as long as we pass a credible plan that brings our debt-to-GDP level to sustainable levels in a reasonable amount of time, it will create enough certainty in the bond markets to stave off disaster and allow us the time to implement that plan. Is that correct?

Since we agree that the Republican spending bill, HR 1, is not a credible plan and therefore is not an effective way to calm bond markets and delay the onset of a major fiscal meltdown, there seems to be no reason to pass this legislation—legislation that hundreds of notable economists including Goldman Sachs, Mark Zandi and Ben Bernanke believe will cost hundreds of thousands of jobs and endanger our economic recovery.

We know there is a better way.

Mr. Podesta: You outline an alternative, credible plan. The plan has a number of features including reducing spending and increasing revenue. It also, however, includes strategic investments in education, transportation, infrastructure, and R&D, all areas slashed in HR 1. Please explain to the Committee why these kinds of investments are a key component of any credible long-term plan to put our fiscal house in order.

MS. MACGUINEAS' RESPONSE TO MR. HONDA'S QUESTION FOR THE RECORD

You testified today about the psychological aspects of the debt crisis. As I understand it, you are suggesting that as long as we pass a credible plan that brings our debt-to-GDP level to sustainable levels in a reasonable amount of time, it will create enough certainty in the bond markets to stave off disaster and allow us the time to implement that plan. Is that correct?

Yes, that is correct. I believe that we cannot completely backload a plan or it will appear that politicians are merely pushing all the hard choices into the future. But if we adopt a credible multi-year plan we can buy ourselves some time and don't need to implement major policy changes this year when they are more likely to disrupt the economic recovery. It is worth noting that whenever we start fiscal consolidation, it is likely to have short-term negative affects on growth, but it will be extremely beneficial in the long-term compared to doing nothing.

But any plan will have to be credible. I think that means being bipartisan, so one party does not try to undo it, statutory, and coupled with triggers so that if changes do not occur, automatic changes will.

I believe the best approach is a comprehensive, multi-year plan that includes cuts to domestic discretionary spending, as the House Republicans are pushing—though

*EDITOR'S NOTE: As of publication deadline, the committee has received no response from the witness.

I would prefer to wait another year or two for ones this large—but also changes to defense, entitlements and revenues. But it is important that those who oppose the cuts in domestic discretionary spending go on record on the comprehensive budgetary changes they do support-not just argue against those they oppose.

MR. PODESTA'S RESPONSE TO MR. HONDA'S QUESTION FOR THE RECORD

Of course, deficit reduction is going to have be a mix of spending restraint and new revenue. But we cannot ignore a third crucial ingredient: strong economic growth.

There is a broad consensus that overall investment levels are key driver of future economic growth and prosperity. Public investment drives technological innovation and productivity growth, builds a strong workforce through education and job training, and helps new industries like clean energy to grow. Often, it induces the private sector to invest as well: a 2003 study of 17 economically developed countries found that for every dollar of public investment in research and development, private firms spent about 70 cents more thanks to new opportunities created by government investment. And it supports and expands the American middle class, who can take advantage of better education and employment opportunities to start a business or pursue an invention, move up in the workforce, and give their children a better life.

Moreover, while other countries are investing in the technology, infrastructure, and education systems of the future, net U.S. investment is currently at its lowest level since World War II. We need to invest to stay competitive in the global economy, and we are already falling behind.

While our budget problems are too big and too complicated to simply "grow our way out of," without robust economic growth, we can never hope to solve them. Public investment is critical to getting our economy back on track and spurring strong, sustained and broadly shared prosperity. Deficit reduction and renewed public investment need not be mutually exclusive. On the contrary, strong public investment must be made alongside targeted deficit reduction to create jobs, encourage private investment, and help grow our economy back to health.

[Whereupon, at 12:56 p.m., the committee adjourned subject to the call of the Chair]

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